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TRANSCRIPT OF RECORD

Supreme Court of the United States

OCTOBER TERM, 1940

No. 371

ESTATE OF ANNA M. KELLER, PIUS P. KELLER AND MARCELLA V. KELLER, EXECUTORS, PETITIONERS,

vs.

COMMISSIONER OF INTERNAL REVENUE

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT

PETITION FOR CERTIORARI FILED AUGUST 23, 1940.

CERTIORARI GRANTED OCTOBER 14, 1940.

SUPREME COURT OF THE UNITED STATES

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[fol. 1]

BEFORE UNITED STATES BOARD OF TAX APPEALS

Docket No. 93221

Estate of ANNA M. KELLER, PIUS P. KELLER and MARCELLA V. KELLER, Executors, Petitioners,

vs.

COMMISSIONER OF INTERNAL REVENUE, Respondent

Appearances: For Taxpayer: Ferdinand T. Weil, Esq.
For Com'r: Paul E. Waring, Esq.

DOCKET ENTRIES

1938.

Apr. 29. Petition received and filed. Taxpayer notified. (Fee paid.)

Apr. 29. Copy of petition served on General Counsel.

June 23. Answer filed by General Counsel.

June 23. Request for circuit hearing in Pittsburgh, Pennsylvania, filed by General Counsel.

June 29. Notice issued placing proceeding on Pittsburgh, Pa., Calendar. Copy of answer and request served.

Oct. 12. Hearing set Nov. 7, 1938, Pittsburgh, Pa.

Nov. 8. Called 11/7/38. Hearing had before Mr. Black on merits. Submitted. Stipulation of Facts filed. Petitioner's brief due 12/23/38. Respondent's 1/23/39; Reply 2/7/39.

[fol. 2] Nov. 23. Transcript of hearing of Nov. 8, 1938, Pittsburgh, Pa. filed.

1939.

Jan. 5. Motion for leave to file brief two weeks after expiration of prescribed period, brief lodged filed by taxpayer. 1/5/39 granted. 1/6/39 copy served on General Counsel.

Feb. 1. Brief filed by General Counsel.

Mar. 11. Motion for leave to file reply brief—reply brief lodged filed by taxpayer. Granted.

Mar. 11. Copy of motion and reply brief served on General Counsel.

1939.

May 25. Findings of Fact and Opinion rendered, Eugene Black, Div. 15. Decision will be entered for the petitioner.

May 26. Decision entered, Eugene Black, Div. 15.

Aug. 18. Petition for review by United States Circuit Court of Appeals, Third Circuit, with assignments of error filed by General Counsel.

Aug. 23. Proof of service filed by General Counsel. (3).

Oct. 11. Motion for extension of time to Dec. 16, 1939 to complete the record filed by General Counsel.

Oct. 11. Order enlarging time to Dec. 16, 1939 to prepare evidence and transmit record, entered.

Oct. 23. Certified copy of an order from United States Circuit Court of Appeals, Third Circuit directing that 5 copies each of Exhibits "C" and "D" attached to the stipulation of facts as physical exhibits be transmitted to Court, copy of this order to be incorporated in record.

Nov. 27. Praecipe for record filed by General Counsel, with proof of service thereon.

Nov. 27. Agreed statement of evidence lodged.

Nov. 27. Agreed statement of evidence approved and ordered filed.

[fol. 3] BEFORE UNITED STATES BOARD OF TAX APPEALS

PETITION—Filed April 29, 1938

The above named petitioners hereby petition for a redetermination of the deficiency set forth by the Commissioner of Internal Revenue in his Notice of Deficiency, MT-ET-C1-5938, 23rd District Pa., dated January 29, 1938, and as a basis of their proceeding allege as follows:

1. The petitioners are executors of the estate of Anna M. Keller, deceased, Pius P. Keller having his residence at 207 S. Aiken Avenue, Pittsburgh, Pa., and Marcella V. Keller having her residence at 6348 Douglas Street, Pittsburgh, Pa.

The return for the period here involved was filed with the Collector for the 23rd District of Pennsylvania.

2. The Notice of Deficiency (a copy of which is attached hereto and marked Exhibit "A") was mailed to the petitioners on January 29, 1938.

3. The taxes in controversy are estate taxes on the estate of Anna M. Keller who died a resident of Pittsburgh, Pa., assessed upon the estate tax return filed in the year 1936, and are in the amount of $3,243.64.

4. The determination of tax set forth in said Notice of Deficiency is based upon the following errors:

(1) In refusing to apply the $40,000 exemption on a life insurance policy, amounting to only $20,030.43;

(2) In refusing to hold the life insurance policy, amounting to $20,030.43, as insurance within the meaning of Sec- [fol. 4] tion 302 (g) of the Revenue Act of 1926 as amended;

(3) In holding that the purchase of the life insurance policy and the annuity policy amounted in substance to a transfer by trust or otherwise, under which the decedent retained for life the enjoyment of or the right to the income from the property;

(4) In holding that the $40,000 exemption provided by Section 302 (g) of the Revenue Act of 1926 as amended is not applicable to the transaction in this case, and in holding that the item of insurance amounting to $20,030.43 is includible in the decedent's gross estate under the provisions of Section 302 (c) as amended, as a transfer made in contemplation of death and intended to take effect at death;

(5) In refusing to grant the protest filed by your petitioners in this case against the Commissioner's including said policy of $20,030.43 in decedent's gross estate and refusing to apply the $40,000 exemption;

(6) In making the deficiency assessment as shown on the aforesaid Exhibit "A" hereto attached;

(7) In refusing to hold that two policies (one being an insurance policy and the other being an annuity policy) as two separate contracts, and refusing to hold the insurance policy a contract of insurance.

5. The facts upon which the petitioners rely as the basis for this proceeding are as follows:

(1) On December 30, 1934, Mrs. Anna M. Keller, the decedent (being a widow), at the age of 74, signed an application for and on the following day received a single premium life insurance contract with the Equitable Life Assur-

ance Society in the principal amount of $20,000, with a [fol. 5] single payment premium of $17,941.80, naming the insured's daughter as beneficiary (the beneficiary was later changed to provide for other children succeeding as beneficiaries in the event of the aforesaid daughter's death). This policy was never assigned. A true and correct photostatic copy of said policy is hereto attached and marked Exhibit "B";

(2) On the same date, to wit, December 30, 1934, the said Mrs. Anna M. Keller, decedent, signed an application for and the next day received a single premium annuity contract with the same company, to wit, the Equitable Life Assurance Society. The premium was $3,258.20, and the payment was $195.42 payable every six months. The annuity payments were later changed to quarterly payments in lieu of semi-annual payments. This contract was never assigned. A true and correct photostatic copy of said contract is hereto attached and marked Exhibit "C";

(3) At the time the said Anna Keller applied for and executed the aforesaid contract of life insurance and annuity contract, she was in excellent health, was extremely vigorous and active, did not then have and had not suffered any serious illness, had unusual strength, vitality, intelligence and good spirits for one of such advanced years, was not in contemplation of death, and expected to live for many more years.

(4) The said Anna M. Keller died on March 28, 1936.

(5) In the Estate Tax Return filed by your petitioners in the 23rd District of Pennsylvania, the face amount of said life insurance policy, to wit, $20,000, plus $30.45 interest, was set forth, and the $40,000 exemption provided by Section 302 (g) of the Revenue Act of 1926 as amended [fol. 6] was applied in eliminating said insurance from the gross estate, but the Commissioner of Internal Revenue refused to apply said exemption, including the amount of said insurance in the gross estate and imposed the deficiency assessment herein complained of.

Wherefore, your petitioners pray that this Board may hear the proceeding and reverse the action taken by the Commissioner of Internal Revenue and allow your peti-

tioners to apply said exemption against the insurance as above set forth.

Estate of Anna M. Keller, Pius P. Keller, Marcella V. Keller, Executors. Ferdinand T. Weil, Weil, Christy & Weil, Attorneys for Petitioners.

Duly sworn to by Pius P. Keller. Jurat omitted in printing.

[fol. 7] EXHIBIT "A"—PAGE 1

(Copy)

Jan. 29, 1938.

MT-ET-C1-5938-23d Pennsylvania.
Estate of Anna M. Keller.
Date of death March 28, 1936.

Pius P. Keller, et al., Executors, 207 S. Aiken Avenue, Pittsburgh, Pennsylvania.

SIRS:

A deficiency of $3,243.64 in the Federal estate tax liability of the above-named estate has been determined after a review of the file in the case and a consideration of the protest against a deficiency proposed in a previous letter from this office. The determination of the deficiency and the action of this office on the protest are fully explained in the attached statement.

This notice of deficiency is given in accordance with the provisions of Section 308 (a) of the Revenue Act of 1926 as amended by Section 501 of the Revenue Act of 1934, and a petition for a redetermination of the deficiency may be filed with the United States Board of Tax Appeals within 90 days (not counting Sunday or a legal holiday in the District of Columbia as the ninetieth day) from the date of the mailing of this letter. If you acquiesce in this determination and do not desire to file a petition with the United States Board of Tax Appeals, you are requested to execute and forward the enclosed Form 890, waiving the restrictions on the immediate assessment and collection of the deficiency.

The submission of the waiver will expedite the closing of this case and will also benefit the estate by preventing the accumulation of interest charges, as the interest period terminates 30 days after the filing of the waiver or on the date [fol. 8] of assessment, whichever is earlier. The signing of

the waiver does not prejudice your right to file a claim for refund of all or any portion of the tax. If you desire to consent to the assessment and collection of only a part of the deficiency, the enclosed form of waiver should be executed in such partial amount.

If within the 90-day period a petition has not been filed with the United States Board of Tax Appeals or the waiver, Form 890, has not been submitted, the deficiency will be thereafter assessed.

Respectfully, Guy T. Helvering, Commissioner, by D. S. Bliss, Deputy Commissioner.

Enclosures:
Statement,
Waiver, Form 890.

Exhibit "A"—page 2

(Copy)

Jan. 29, 1938.

MT-ET-C1-5938-23d Pennsylvania.
Estate of Anna M. Keller.
Date of death—March 28, 1936.

STATEMENT.

The estate's protest against the Bureau's tentative determination of July 2, 1937, was the subject of a letter of proposed determination dated October 4, 1937, to which the estate apparently does not agree.

In its letter of proposed determination the Bureau adhered to its tentative determination and included in the [fol. 9] gross estate the full value at the date of death of the insurance policy taken out by the decedent with the Equitable Life Assurance Society, without benefit of any portion of the $40,000.00 exemption.

You are advised that this office is in receipt of information to the effect that the Equitable Life Assurance Society issued life insurance policy No. 9652636 in conjunction with life annuity policy No. 9652635 and that the company would not have issued the ordinary life policy to the decedent at her attained age of 75 years without issuing a life annuity contract.

Accordingly, it appears that the purchase of the two policies amounted in substance to a transfer by trust or otherwise under which the decedent retained for life the enjoyment of or the right to the income from the property.

Accordingly, it is held that the $40,000 exemption is not applicable to the transaction and that the item is includible in the decedent's gross estate under the provisions of section 302 (c), as amended, as a transfer made in contemplation of death and intended to take effect at death. The action of the Bureau upon the protest is more particularly shown below.

Gross Estate

Insurance	Returned	Proposed Determination	Determined
Item 1	$0.00	$20,030.43	$0.00
Transfers			
Item 1 of insurance policy #9,652,636	$0.00	$0.00	$20,030.43

[fol. 10] Exhibit "A"—page 3

Page #2—Statement
Jan. 29—1938

Gross Estate		$261,994.79
Deductions, 1926 Act		111,355.36
Net estate, 1926 Act		$150,639.43
Gross estate		$261,994.79
Deductions, 1935 Act		51,355.36
Net estate, 1935 Act		$210,639.43
Gross tax, 1926 Act	$3,019.18	
Credit for estate or inheritance tax	2,415.34	
Net tax, 1926 Act		603.84
Total gross taxes, 1926 and 1935 Acts	28,727.89	
Gross tax, 1926 Act	3,019.18	
Net additional tax		$25,708.71
Total net tax		$26,312.55
Returned tax	$21,609.68	
Amount assessed pursuant to waiver	1,459.23	23,068.91
Deficiency		$3,243.64

The deficiency bears interest at the rate of six per cent per annum from fifteen months after the decedent's death to the date of assessment, or to the thirtieth day after the filing of a waiver of the restrictions on the assessment, whichever is the earlier.

[fol. 11] BEFORE UNITED STATES BOARD OF TAX APPEALS

ANSWER—Filed June 23, 1938

The Commissioner of Internal Revenue, the respondent herein, by his attorney, J. P. Wenchel, Chief Counsel, Bureau of Internal Revenue, for answer to the petition filed by the above-named petitioners, admits and denies as follows:

1, 2. Admits the allegations contained in paragraphs Nos. 1 and 2 of the petition.

3. Admits that the taxes in controversy are estate taxes on the estate of Anna M. Keller who died a resident of Pittsburgh, Pa., but denies the remaining allegations contained in paragraph No. 3 of the petition.

4. (1), (2), (3), (4), (5), (6), (7). Denies that the determination of the deficiency is based upon errors as alleged in paragraph No. 4 (1), (2), (3), (4), (5), (6) and (7) of the petition.

5. (1). Admits so much of paragraph No. 5 (1) of the petition as alleges that Mrs. Anna M. Keller, the decedent, signed an application for and received a single premium contract with the Equitable Life Assurance Society in the principal amount of $20,000 with a single payment premium of $17,941.80, and that a true and correct photostatic copy of said policy is attached to the petition and marked Exhibit B, but denies all other allegations contained in paragraph No. (1) of the petition.

(2). Admits so much of paragraph No. 5 (2) of the petition as alleges that on the same date Mrs. Anna M. Keller, the decedent, signed an application for and received a single premium annuity contract with the same company, to-wit, [fol. 12] the Equitable Life Assurance Society; that the premium was $3,258.20 and the payment was $195.42 payable every six months, and that a true and correct photostatic

copy of said contract is thereto attached and marked Exhibit C, but denies all other allegations contained in paragraph No. 5 (2) of the petition.

(3). Denies the allegations contained in paragraph No. 5 (3) of the petition.

(4). Admits the allegations contained in paragraph No. 5 (4) of the petition.

Admits so much of paragraph No. 5 (5) of the petition as alleges that in the estate tax return filed by the petitioners in the 23rd District of Pennsylvania, the face amount of said policy to-wit, $20,000 plus $30.45 interest was set forth; that the $40,000 exemption was applied in eliminating said amount from the gross estate and that the Commissioner of Internal Revenue refused to apply said exemption, but denies all other allegations contained in paragraph No. 5 (5) of the petition.

Denies generally and specifically each and every allegation contained in the petition, not hereinbefore admitted, qualified or denied.

Wherefore, it is prayed that the Commissioner's determination be approved.

(Signed) J. P. Wenchel, G. W. K., Chief Counsel, Bureau of Internal Revenue. Of Counsel: Lewis S. Pendleton, Special Attorney, Bureau of Internal Revenue.

LSP/bj 6/23/38.

[fol. 13] BEFORE UNITED STATES BOARD OF TAX APPEALS

Docket No. 93221. Promulgated May 25, 1939

ESTATE OF ANNA M. KELLER, PIUS P. KELLER and MARCELLA V. KELLER, Executors, Petitioners,

v.

COMMISSIONER OF INTERNAL REVENUE, Respondent

FINDINGS OF FACT AND OPINION—Filed May 25, 1939

While in good health and not in contemplation of death, the decedent, who was 75 years of age, and an insurance

company entered into two separate contracts, one a single premium life insurance policy for the face amount of $20,000 and the other a single premium life annuity. The decedent was not required to take a medical examination and the company would not have issued the insurance policy without the purchase by the decedent of the annuity. Both contracts were on the regular standard form used by the company in writing life insurance and annuities, respectively. The decedent died March 28, 1936, after having received two payments on the annuity contract and all payments under the annuity policy ceased. Upon her death the insurance company paid the face value of the insurance policy together with a post mortem dividend of $30.43 to the beneficiary named in the policy. Held, the amount of $20,030.43 received by the beneficiary represented "insurance" as that term is used in section 302 (g) of the Revenue Act of 1926, as amended and not being in excess of the exemption of $40,000, should not be included in decedent's gross estate. Old Colony Trust Co. et al., Executors, 37 B. T. A. 435; aff'd., 102 Fed. (2d) 380, distinguished.

[fol. 14]—Ferdinand P. Weil, Esq., for the petitioners.

Paul E. Waring, Esq., for the respondent.

The respondent determined a Federal estate tax deficiency against petitioners in the amount of $3,243.64. The sole question is whether an amount of $20,030.43 paid by an insurance company to the beneficiary named in an insurance policy which policy was taken out by the decedent at the age of 75 on the same day that she took out an annuity policy and would not have been issued without the annuity policy, represents "insurance" as that term is used in section 302 (g) of the Revenue Act of 1926 as amended and, not being in excess of the specific exemption of $40,000, is therefore not includable in the decedent's gross estate, or whether the amount paid was not insurance within the meaning of section 302 (g) but in substance represents a "transfer" made by the decedent under such circumstances as would require the inclusion of the amount in the decedent's gross estate under section 302 (c) of the Revenue Act of 1926 as amended.

Findings of Fact

Petitioners are the executors of the estate of Anna M. Keller, deceased, and reside in Pittsburgh, Pennsylvania.

The decedent died March 28, 1936, a citizen of the United States and a resident of Pittsburgh.

On December 31, 1934, the decedent at the age of 74¾ years, effective at the age of 75, executed a contract with the Equitable Life Assurance Society of the United States, sometimes hereinafter referred to as the insurance company. On its face the contract was designated "Life Annuity. Single Premium. Non-Participating." This contract is numbered 9,652,635 and provides for the payment of a single premium of $3,258.20 to the insurance company in consideration for semiannual annuity income payments of [fol. 15] $195.42 by the insurance company to the annuitant during her lifetime. The contract was on the regular standard form used by the insurance company for writing annuity contracts, and among other things provided that "this agreement, and the application therefor, a copy of which is endorsed hereon or attached hereto, constitute the entire contract between the parties." The application for the contract was made by the decedent on November 28, 1934, and reads in part as follows:

Application is hereby made for a Life Annuity providing for semi-annual payments of $195.42 each, with a single premium of $3,258.20 payable in advance.

On the same day that the annuity contract was executed December 31, 1934, the decedent also executed a policy or contract with the insurance company for the face amount of $20,000 which was numbered $9,652,636 and was designated on its face as "Single Premium Life Policy. Insurance Payable At Death. Single Premium. Annual dividends." The policy was on the regular standard form used by the insurance company for writing life insurance policies, and among other things provided:

The Equitable Life Assurance Society of the United States, a mutual company, organized July 26, 1859, Hereby Insures the Life or Anna M. Keller (Herein Called The Insured) and Agrees to Pay At Its Home Office in the City of New York Twenty Thousand Dollars (Herein Called The Face Amount) to the Insured's daughter, Marcella V. Keller, beneficiary (with the right of the Insured to change the beneficiary or assign this policy) Upon Receipt of Due Proof of Death Provided This Policy Is Then in Force and Is Then Surrendered Properly Released.

This insurance is granted in consideration of the payment in advance to the Society of a single premium of [fol. 16] Seventeen thousand nine hundred forty-one and 80/100 Dollars.

The policy was incontestable after it had been in force during the lifetime of the insured for a period of two years from the date of issue. As to participation in dividends, it provided that at the end of the first and each subsequent policy year any surplus apportioned by the insurance company to this policy as a dividend should at the option of the insured be:

1. Paid in cash; or

2. Applied to the purchase of paid-up Additional Insurance, and the Insured may at any time surrender such Additional Insurance and receive the cash value thereof which shall not be less than the original cash Dividend; or

3. Left to accumulate at 3% interest, compounded annually * * *.

The policy further provided that if the insured did not elect one of the foregoing options within three months after the mailing of a notice requiring such election, the dividend was to be applied as provided under option 2. Whenever during the lifetime of the insured the reserve on the policy equaled the face amount thereof, the policy was to be regarded as a matured endowment, and upon the surrender of the policy the company agreed to pay the insured "the face amount of insurance hereunder less any indebtedness." The policy also contained provisions relating to assignments, change of beneficiary, policy years, age and self-destruction. There was a provision captioned "The Contract" which provided as follows:

This policy, and the application therefor, a copy of which is endorsed hereon or securely attached hereto, constitute the entire contract between the parties. All statements [fol. 17] made by the Insured shall, in the absence of fraud be deemed representations and not warranties, and no statements shall avoid this policy or be used in defense of a claim hereunder unless contained in the written application therefor and a copy of such application is endorsed hereon or attached hereto, when issued.

The policy contained a "Table of Loan and Cash Surrender Values for each $1,000 of Face Amount" for a period of 20 years, as follows:

Years	Cash Value
1	$814
2	825
3	836
4	847
5	859
6	867
7	878
8	888
9	899
10	909
11	917
12	924
13	932
14	938
15	945
16	951
17	957
18	962
19	966
20	970

The loan value of the policy was the cash value thereof less interest to the end of the policy year. The cash value provided for in the above table represented the full reserve at the end of the respective current policy year, less [fol. 18] a surrender charge of not less than 2 percent of the face of the policy during the first 10 years. The basis of computation of the reserve for which funds were to be held upon the policy was to be computed upon the American Experience Table of Mortality, with interest at 3 percent. The policy further provided for four different options or modes of settlement at maturity. The application for the policy was made by the decedent on November 28, 1934, and reads in part as follows:

I hereby apply for a policy on my life for $20,000 for the benefit of my daughter, Marcella V. Keller if living at my death, otherwise as stated in policy, with right to change the beneficiary or assign the policy reserved to me . . . .

Based upon the mortality table forming the basis for the annuity rate under contract No. 9,652,635, the expectation of life of a female of the age of 74¾ years is 10.5 years.

On the basis of the mortality table used to compute the premium under policy No. 9,652,636, the expectation of life of a female at the age of 75 is 6.3 years.

A physical examination of the insured was not required by the insurance company in connection with the execution or issuance of the single premium life policy No. 9,652,636. The company accepted in lieu of a medical examination the issuance of the life annuity contract, through which the company reduced but did not entirely eliminate its risk against loss due to premature death. The insurance company would not have issued the insurance policy to the insured at her attained age of 75 years without issuing a life annuity contract in conjunction with the insurance policy or as a conversion from a group certificate. The basic rate at age 75 is consistent with the rate chargeable at the younger ages where, provided satisfactory evidence [fol. 19] of insurability is furnished, a life insurance policy may be issued in the absence of an annuity contract. The consideration charged for the annuity contract would have been the same even if no life insurance had been purchased at the time. The decedent could have obtained the annuity contract without the insurance policy, in which case the annuity would have been identically the same as provided in the annuity contract which was issued to the decedent on December 31, 1934. The requirement of the annuity contract as a condition precedent to the issuance of the insurance policy was due to the amount of risk involved, namely, the difference between the consideration and the death benefit.

The total consideration paid by the decedent to the insurance company for the two contracts amounted to 106 percent of the face amount of the insurance policy or $21,200 which was $1,200 in excess of the face amount of the insurance policy. The name given to the $1,200 by the insurance company is "loading" and is for the purpose of paying commissions to the general agent and the special agent and for premium taxes. The actual expense exclusive of general overhead expense of the insurance company in

issuing the two contracts in question was the amount of $1,475.97, itemized as follows:

	Insurance policy	Annuity contract	Total
Commission	$897.09	$114.04	$1,011.13
Expense allowance to general agent	89.71	16.29	106.00
Premium tax	358.84	.....	358.84
Total expense	1,345.64	130.33	1,475.97

The above total charge of 106 percent was later found to be unprofitable, at which time the charge was increased to 110 percent, and still later the issuance of an insurance [fol. 20] policy like the one in question was made conditional upon a medical examination.

The insurance company at all times treated the two contracts entered into with the decedent on December 31, 1934, as two separate transactions rather than as one transaction.

The single premium of $17,941.80 received for insurance policy No. 9,652,636 was credited on the insurance company's books to the account "First year insurance premiums, Ordinary", whereas the single premium of $3,-258.20 received for annuity contract No. 9,652,635 was credited to the account "First year annuity premiums, Ordinary." The funds so received were merged with the general funds of the insurance company. The compensation paid with respect to the insurance policy was charged to the account "Commissions on first year insurance premiums, Ordinary," whereas the compensation paid with respect to the annuity contract was charged to the account "Commissions on first year annuity premiums, Ordinary."

At December 31, 1934, the insurance company, in determining its liability with respect to outstanding contracts, included in its annual statement to the Superintendent of Insurance of the State of New York under the heading "Net present value of all the outstanding policies in force on December 31 of current year, as computed on the following tables of mortality and rates of interest, viz: '3. American Experience Table at 3% on issues of 1895 and

after' '', the amount of $16,580 as the net present value of Insurance of the State of New York under the heading "5. Net present value of annuities (including those in reduction of premiums), viz: Combined Annuity Table (1st modification) at 3¾%", the amount of $3,021 as the net present value of the annuity contract. Similar items were included in the corresponding annual statement at Decem-
[fol. 21] ber 31, 1935, in the following respective amounts: Insurance, $16,760; annuity, $2,900.

At the time the notice of decedent's death was received at the home office of the insurance company an entry was included in the cancellation list for policies terminated by death indicating the termination of the insurance policy, and this list was used as the basis for making the various records maintained in the insurance company's office with respect to the status of that policy. A similar entry with respect to the annuity contract was included in the cancellation list for annuity contracts terminated by death, and the information on this record was similarly used.

At the time of the decedent's death the death benefit provided by the insurance policy was charged to the account "Death Claims Ordinary." No benefit at death was provided by the annuity contract, and there was consequently no entry in the books of account at the time of death with respect to that contract.

The single premium charged for insurance policy No. 9,652,636 of $17,941.80 is 20 times the single premium per thousand dollars of whole life insurance at age 75, that is, $897.09. The single premium of $897.09 is computed from the net premium based on the American Experience Table of Mortality at 3 percent interest with a proper loading for expenses. The mortality table and loading formula used are consistent with the basis of rates for single premium whole life insurance at all other ages.

The single consideration of $3,258.20 collected on contract No. 9,652,635 is based on American Annuitants Select Male Table of Mortality at 3¾ percent interest, modified for female lives. The net consideration required to provide the semiannual income of $195.42 according to this table was loaded for expenses.

[fol. 22] The term "Ordinary Life" is the designation applied to a life insurance policy under which premiums are payable throughout the entire lifetime of the insured whether annually, semiannually, quarterly or monthly.

Where the premium for a life insurance policy under which the proceeds are payable at death of the insured, whenever that may occur, is paid in a single sum at issue, the policy is referred to as a "single premium whole life policy."

For the year 1934 and for several years prior to 1938 the insurance company's earnings on its own funds held for investment purposes ranged from 3½ to 4 percent.

The decedent during her lifetime received on policy No. 9,652,635 two semiannual income payments in the year 1935 each in the amount of $195.42, making a total of $390.84, and also received in 1935 a dividend disbursement in connection with policy No. 9,652,636 amounting to $122.60. Upon the death of the decedent the insurance company also paid the $20,000 face amount of policy No. 9,652,636 to Marcella V. Keller, the beneficiary named in the policy, plus a post mortem dividend of $30.43 paid in death claim settlement.

On November 6, 1936, petitioners filed an estate tax return for the estate of the decedent with the collector of internal revenue for the twenty-third district of Pennsylvania. Under schedule C-2 of the return relating to "Insurance", petitioners made the following report:

Item No.	Description	Value of Proceeds at date of death
1.	Single Premium Life Policy No. 9652,636, issued by The Equitable Life Assurance Society. Beneficiary Marcella V. Keller, daughter of decedent	$20,030.43
	Total	$20,030.43
[fol. 23]	Less amount of insurance receivable by beneficiaries, other than the estate, not in excess of $40,000	20,030.43
	Total Included	00.00

Under schedule E of the return relating to "Transfers" petitioners reported that there were no transfers includable in the decedent's gross estate.

In a statement attached to the deficiency notice the respondent notified petitioners in part as follows:

In its letter of proposed determination the Bureau adhered to its tentative determination and included in the

gross estate the full value at the date of death of the insurance policy taken out by the decedent with the Equitable Life Assurance Society, without benefit of any portion of the $40,000.00 exemption.

You are advised that this office is in receipt of information to the effect that the Equitable Life Assurance Society issued life insurance policy No. 9,652,636 in conjunction with life annuity policy No. 9652635 and that the company would not have issued the ordinary life policy to the decedent at her attained age of 75 years without issuing a life annuity contract.

Accordingly, it appears that the purchase of the two policies amounted in substance to a transfer by trust or otherwise under which the decedent retained for life the enjoyment of or the right to the income from the property. Accordingly, it is held that the $40,000 exemption is not applicable to the transaction and that the item is includible in the decedent's gross estate under the provisions of section 302 (c), as amended, as a transfer made in contemplation of death and intended to take effect at death.

The principal cause of decedent's death was cerebral [fol. 24] hemorrhage of one-half day duration. A contributory cause was la grippe of 14 days duration.

Up until the time of her last illness the decedent had enjoyed excellent health, had been remarkably free from any illnesses or disabilities, and had been especially active for one of her years. She enjoyed motoring, taking trips, and attending baseball games. A short time before her death she spoke about going abroad for that summer, and two days before her death she suggested getting tickets for the opening baseball game. She was a woman who enjoyed life and never expressed any expectancy of dying, nor mentioned death, and for four or five years prior thereto her blood pressure and general condition had been especially good and in no way indicated the likelihood of a stroke or cerebral hemorrhage. Her mother and her grandmother were both in their nineties when they died.

The amount of $20,030.43 paid by the insurance company to the beneficiary named in insurance policy No. 9,652,636 is not includable in the decedent's gross estate as a transfer made in contemplation of death or otherwise. The amount so paid represents "insurance under policies taken out by the decedent upon her own life" as that term is used in section 302 (g) of the Revenue Act of 1926, as amended.

OPINION

Black: The question involved has been previously stated. The applicable statute is section 302 of the Revenue Act of 1926 as amended by section 803 (a) of the Revenue Act of 1932 and section 404 of the Revenue Act of 1934, the material provisions of which are set out in the margin.[1] [fol. 25] Petitioners contend that the amount of $20,030.43 paid by the insurance company to the decedent's daughter Marcella V. Keller represents "insurance under policies taken out by the decedent upon her own life" as that term is used in subdivision (g) of the applicable statute, and that, since the amount was not in excess of the specific exemption of $40,000 provided for in subdivision (g), no part thereof should be included in the decedent's gross estate. No other beneficiaries received any amount as insurance under any policy taken out by the decedent upon her own life, and the [fol. 26] $20,030.43, if insurance, was the only insurance received by Marcella V. Keller as the beneficiary under a policy taken out by the decedent upon her own life. On the other hand, the respondent contends that the insurance policy and the annuity contract must be regarded as one single, indivisible contract between the decedent and the insurance company; that as so regarded the two contracts in substance amounted to a "transfer" of $21,200 (the total

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[1] Sec. 302. The value of the gross estate of the decedent shall be determined by including the value at the time of his death of all property, real or personal, tangible or intangible, wherever situated, except real property situated outside the United States——

* * * * * * *

(c) To the extent of any interest therein of which the decedent has at any time made a transfer, by trust or otherwise, in contemplation of or intended to take effect in possession or enjoyment at or after his death, or of which he has at any time made a transfer, by trust or otherwise, under which he has retained for his life or for any period not ascertainable without reference to his death or for any period which does not in fact end before his death (1) the possession or enjoyment of, or the right to the income from, the property, or (2) the right, either alone or in conjunction with any person, to designate the persons who

premiums paid for both contracts) made by the decedent during her lifetime both (1) in contemplation of death, and (2) under such circumstances whereby the decedent retained for her life the enjoyment of or the right to the income from the property transferred; that the value of the transfer upon the decedent's death was the amount of $20,030.43 which was paid by the insurance company to the decedent's daughter; and that the latter amount was therefore includable in the decedent's gross estate under subdivision (c) of the applicable statute referred to above and not under section 302 (g) as insurance.

The controversy in this proceeding concerns two separate and distinct contracts, one a single premium life insurance policy and the other a single premium life annuity. Both policies were written on the regular standard forms and on the basis of the respective mortality table ordinarily used in writing life insurance and annuities, respectively. Each contract contains a proviso to the effect that the agreement and the respective application therefor "constitute the entire contract between the parties." The application for each contract was made by the decedent on the same day and the contracts were executed on the same day. Petitioners, however, concede that the insurance company would not have issued the life insurance policy to the decedent at her attained age of 75 without issuing a life annuity contract "in conjunction with" the life insurance policy, but

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shall possess or enjoy the property or the income therefrom; except in case of a bona fide sale for an adequate and full consideration in money or money's worth. Any transfer of a material part of his property in the nature of a final disposition or distribution thereof, made by the decedent within two years prior to his death without such consideration, shall, unless shown to the contrary, be deemed to have been made in contemplation of death within the meaning of this title.

* * * * * * *

(g) To the extent of the amount receivable by the executor as insurance under policies taken out by the decedent upon his own life; and to the extent of the excess over $40,000 of the amount receivable by all other beneficiaries as insurance under policies taken out by the decedent upon his own life.

contend that this requirement was merely a condition prece-
[fol. 27] dent to the issuance of the life insurance policy which was imposed by the insurance company for the purpose of reducing but not entirely eliminating its risk against loss due to premature death, and that such a condition when once complied with does not make the insurance policy when once issued any different than any other insurance policy issued on identically the same kind of form to an applicant who is not required also to purchase an annuity. Petitioners argue that insurance companies have a right to require certain reasonable conditions precedent before they will issue a certain type of policy, but, once this condition precedent is complied with, the contract must be interpreted in accordance with its actual terms. Williston, in his chapter on general rules for the interpretation or construction of contracts, says at section 628:

> Where a writing refers to another document, that other document, or so much of it as is referred to in it, is to be construed as part of the writing. * * * Even where a writing does not refer to another writing, if such other writing was made as part of the same transaction, the two should be construed together. It is usually said that the two writings together form one contract. Though this is generally true, it is not always accurate, even though the several writings are part of the same bargain. Where one of the writings is a formal document it cannot be incorporated in an ordinary writing. A note and a mortgage to secure it are not strictly one contract, though doubtless each is to be construed in connection with the other in order to determine its meaning. * * *

In the instant proceeding it is our opinion that the two contracts must be construed in connection with each other and that in so doing it is of no great importance whether the things agreed upon by the decedent and the insurance company on December 31, 1934, were embodied in one policy
[fol. 28] or two. The question in either event remains the same, namely, whether the amount of $20,030.43 paid by the insurance company to the decedent's daughter was paid to her as "insurance" as petitioners contend or as the result of a transfer in trust or otherwise made by the decedent in contemplation of death and intended to take effect at death as the respondent contends and not as "insurance."

Even if the decedent and the insurance company had executed all the things they agreed to on December 31, 1934, in one document instead of two, the cases hold that if the agreement sets forth separate features which are clearly severable, each feature must be given its proper application. Equitable Life Assurance Society of United States v. Deem, 91 Fed. (2d) 569; Connecticut General Life Insurance Co. v. McClellan, 94 Fed. (2d) 445; Downey v. German Alliance Insurance Co. 252, Fed. 701; Legg v. St. John, 296 U. S. 489.

In Legg v. St. John, supra, the question before the Supreme Court was whether Legg, a voluntary bankrupt, or his trustee was the person entitled to certain future monthly disability benefits payable under a contract entered into between Legg and an insurance company before the adjudication. Several years prior to the adjudication Legg took out a life insurance policy under which the company agreed, in consideration for a stated annual premium, to pay a certain amount upon his death. By a supplementary contract issued on the same day and attached to the policy, the company, in consideration for an additional annual premium of a stated amount, agreed to pay a monthly benefit of $174.52 upon due proof of total and permanent disability, which latter event happened several years before the adjudication. In holding that the disability benefits were payable to the trustee and not to the bankrupt, Mr. Justice Brandeis in the course of his opinion said:

[fol. 29] *Second.* The fact that the disability benefits are provided for in a "Supplementary Contract" issued on the same day as the policy and physically attached thereto does not make them life insurance. The life policy and the contract were executed as distinct instruments. The "Supplementary Contract" was to operate for some purposes as if a part of the life policy. But for all other purposes it is a separate obligation. The hazards covered by the two instruments are obviously different. The beneficiaries differ also. The payment under the life policy was to be made to the wife; the disability benefits are to be paid to Legg himself. A separate and different premium was exacted for the obligations assumed in each instrument. It was provided that forfeiture of the life policy would terminate all rights arising from disability; but the supplementary contract could be terminated by Legg without affecting otherwise his life policy.

In the instant proceeding we think the agreement between the decedent and the insurance company as evidenced by the two documents, the insurance policy and the annuity contract, shows an intention on the part of the contracting parties to enter into an insurance and annuity contract with clearly severable features as to each, rather than a contract of trusteeship with no separate features. For example, the insurance company agreed to pay Mrs. Keller a life annuity of $390.84. Her life expectancy was 10.5 years when the contract was taken out and if she had lived that expectancy the total payments to her would have been $4,103.82 which apparently would have been a full return except the comparatively small amount for "loading" to her of the premium of $3,258.20 plus the interest earned thereon. But suppose she had lived to be as old as her mother and grandmother, which the evidence shows was 90 years each. That would have meant that the insurance company would have paid her annuities of $390.84 for 15 years which would have [fol. 30] been $5,862.60. This would apparently have been considerably more than the total premium of $3,258.20 which she paid for the annuity, plus the interest earned thereon. Of course, regardless of how long Mrs. Keller had lived, the insurance policy of $20,000 payable at death to her designated beneficiary would have remained the same. Attention is called to these features in order to show the clear separability of the two contracts notwithstanding that they were taken out as parts of one transaction. The writings did not take the form of any declaration of trust. No provision was made for any compensation to be paid the insurance company as trustee. The decedent was referred to in one instrument as "The Insured" and in the other instrument as the "Annuitant." The only considerations contracted for by the insurance company were the two separately stated premiums of $17,941.80 and $3,258.20, respectively. Each premium was based upon a different mortality table, one appertaining to life insurance and the other to life annuities. The obligations of the insurance company, as we have already pointed out, were different as to each separate feature. In consideration for the single premium of $17,941.80 it agreed to pay the decedent's daughter $20,000 upon receipt of due proof of the death of the decedent. This feature also provided for a participation in dividends and provisions for loans and a cash surrender value. The latter began at $16,280 after the policy had been in force

for one year and gradually increased to $19,400 over a period of 20 years. In consideration for the single premium of $3,258.20 the company merely agreed to pay the decedent a semiannual annuity of $195.42 during her lifetime. The latter had no cash surrender value and all obligations under this feature ended completely upon the death of the decedent. After a period of one year the insurance feature could be eliminated by the decedent electing to surrender that feature for its cash value without in any way affecting [fol. 31] the annuity feature. It seems to us that the situation is simply this: Even assuming that Mrs. Keller did not want to purchase an annuity (and we have no evidence to that effect) and only did so because she had to do it to secure the life insurance policy which she did want, nevertheless when the purchase was complete she owned two contracts and we have no cause to say that her life insurance policy was not life insurance merely because she had to purchase an annuity policy along with it. We are cited to no authority which would compel any such holding. Suppose we look at the insurance policy from the standpoint of the insurance company which wrote the policy rather than from the standpoint of petitioner, who took it out. The evidence in this proceeding shows that in determining its liability with respect to outstanding contracts the insurance company included in its annual statement to the Superintendent of Insurance of the State of New York for the year ending December 31, 1934, the insurance policy at a present value of $16,580. Reserves, of course, had to be carried by the insurance company for this amount to make good its liability under the policy. Under the provisions of section 203 (a) (2) of the Revenue Act of 1934, in determining its net income subject to tax the insurance company is allowed to deduct "An amount equal to 4 per centum of the mean of the reserve funds required by law and held at the beginning and end of the taxable year * * *." Could it be plausibly contended that the insurance company in determining the mean of its reserve funds would not have the right to include the reserves held to insure the payment of this insurance policy? We think not. It seems to us that the named reserve of $16,580 would be such reserves as are contemplated by section 203 (a) (2). They are not mere solvency reserves. They are life insurance reserves "required by law." Cf. Helvering v. Illinois Life Insurance

Co., 299 U. S. 88; Helvering v. Inter-Mountain Life Insurance Co., 294 U. S. 686.

[fol. 32] Notwithstanding these separate features to which we have referred, which we think are severable and should be so treated, the respondent contends that because the insurance company would not have issued the insurance policy without the annuity this fact alone controls and brings the instant proceeding within the rule enunciated in Old Colony Trust Co., et al., Executors, 37 B. T. A. 435; affirmed by the First Circuit on March 2, 1939, 102 Fed. (2d) 380, and followed in Chemical Bank & Trust Co., et al., Executors, 37 B. T. A. 535. Those cases, however, involved an entirely different situation than is involved here in that there was no separate insurance feature present in either of them. In the Old Colony case the contract was designated on its face "life annuity with principal sum payable at death." In the Chemical Bank case the contract was designated on its face as "Investment Annuity. Death Refund Payable at Death of Annuitant." Life insurance was not mentioned in either contract. There was but one consideration paid in each of those cases, whereas the decedent here agreed to pay two separate premiums, one for insurance as such and the other for an annuity as such. The contracting party other than the respective insurance company in each of the cases relied upon by the respondent was referred to throughout those instruments as the "Annuitant" and nowhere therein was he ever referred to as the insured. The annuity in each case was calculated on a basis of 3½ per cent on the principal sum and only this 3½ per cent was paid to the annuitant plus any excess interest earned and there was no diminution of the principal fund. Even as to the kind of contracts just described, the court in Bodine v. Commissioner, — Fed. (2d) — (Apr. 4, 1939), held them contracts of insurance and in that respect took issue with In re Thornton's Estate, 186 Minn. 351; 243 N. W. 389, and Ballou v. Fisher, 154 Ore. 548; 61 Pac. (2d) 433. In the Old Colony case the "principal sum" of $40,000 was payable to the annuitant "at any time, provided there is no legal restriction [fol. 33] to the contrary" and in the Chemical Bank case the "death refund" of $20,000 was payable to the annuitant "at any time prior to the death of the Annuitant * * *." In the instant proceeding the annuity feature had no cash surrender value, and the decedent after paying her single premium of $3,258.20 could recover not one cent more than

her semiannual annuity of $195.42 and these payments ceased with the last payment falling due prior to her death. In the instant proceeding the decedent could have surrendered her insurance policy after it had been in force for one year for its stated cash surrender value of $16,280, which was $3,720 less than its face amount, and the surrender thereof would not have affected her annuity in any way. Cash surrender values are common incidents of life insurance policies. Legg v. St. John, supra.

It is these differences which we think compel us to recognize the separate features of "insurance" and "annuity" that are here involved. The annuity contract issued to the decedent was the same contract that would have been issued to any female person of her age for a single premium of $3,258.20. It was a plain annuity, no more and no less. Likewise the insurance policy was a plain, ordinary policy of insurance. It was no different in its terms from hundreds of insurance policies that are being written by the insurance companies every day. We think effect should be given to these policies in accordance with their plain terms, rather than to hold as the respondent has determined. It is therefore our opinion that at the time of the death of Anna M. Keller she was the owner of a $20,000 insurance policy in the Equitable Life Assurance Society of the United States, of which her daughter, Marcella V. Keller, was the designated beneficiary and the $20,030.43 in question represents "insurance" as that term is used in section 302 (g) of the Revenue Act of 1926 as amended, and since the amount is not [fol. 34] in excess of the $40,000 exemption provided for in the statute, no part thereof is includable in the decedent's gross estate. Congress can, of course, remove the $40,000 insurance exemption contained in section 302 (g) at any time it sees fit, but as long as the exemption is there we have no cause to deny it under such circumstances as exist in the instant case.

Reviewed by the Board.

Decision will be entered for the petitioners.

CONCURRING OPINION

HARRON, concurring:

The provisions of section 302 (g) of the Revenue Act of 1926 as amended provide that there shall not be included in

the value of the gross estate of a decedent any amount not in excess of $40,000 receivable by beneficiaries "as insurance under policies taken out by the decedent upon his own life." The Equitable Life Assurance Society of the United States issued a single premium life policy on the life of Anna M. Keller on December 31, 1934; in the face amount of $20,000 in consideration of a premium of $17,941.80. After the death of the insured, the insurance company paid to the beneficiary of the insured the face amount of the policy plus a post mortem dividend. There can be no question whatever that the insurance company entered into a contract to pay a certain sum upon the death of an insured person in excess of the premium paid and fulfilled that contract. The question comes to this Board upon facts relating to a completed bona fide contract. Strictly speaking, we are not concerned with matters of concern only to the insurance company such as whether it waived some of its usual procedures preliminary to executing the contract, such as physical examination of the insured. Nor is it material in this case that the insurance company executed a life insurance contract in conjunction with an annuity contract. Insurance companies sell many types of insurance which combine life insurance with other benefits such as annuity payments. [fol. 35] Such policies have various names, such as endowment policies. In the instance before us, the insurance company executed two policies, one an annuity policy. To the insurance company, there were two contracts having separate terms and separate benefits. Upon the death of the insured the annuity contract terminated and nothing passed under this contract to decedent's beneficiary. May we go outside the terms of executed contracts fully performed and decide the question as though the parties had executed a different contract or contracts? I believe we may not do so, at least where the contracts are bona fide. Further, it may not be said that the question, as decided by the majority opinion, has been decided upon a superficial consideration of labels attached to contracts. The insurance company issued a standard insurance policy upon the life of the decedent and set up upon its books a contract of life insurance. It treated this contract separately from the annuity contract executed at the same time and there is no basis in fact for stating that one contract lost its identity in the other any more than could be said if an individual executed two separate contracts of insurance upon his own life on the same date and

paid separate premiums for each just because the moneys paid merged with other funds of the insurance company. Perhaps the risk of the insurance company was lessened by the purchase of the annuity policy at the same time, but it does not follow that every element of risk was eliminated. As a matter of fact, the decedent died before expiration of the expectation of life which she had under American Experience Mortality Tables. The insurance company took the risk that the insured might not survive her full life expectancy, as an insurer does under every life insurance contract. The facts do not, in my opinion, afford a basis upon which could be made a finding of fact or a conclusion on a mixed question of law and fact that the single premium life policy, No. 9,652,636, was not insurance on the life of [fol. 36] decedent. Unless such finding can be made, we are not justified in holding that the proceeds of that policy do not come within the statutory exclusion allowed by section 302 (g).

In Old Colony Trust Co. et al., Executors, 37 B. T. A. 435, the facts were substantially and materially different from the facts in this proceeding. The contract involved there had none of the characteristics of a life insurance contract, other than that an amount was payable on the death of the annuitant to his beneficiaries. The total premium paid for that policy exceeded the face amount of the policy. There the insurance company did not waive any of its usual procedures preliminary to issuing life insurance for the plain reason that it was not writing a life insurance policy. The premium paid was not computed as is a premium for life insurance. The death of the annuitant was not the sole contingency for payment of the face amount of the policy. That case is clearly a different case from the present one and there is no inconsistency between our holding there and our holding here. As a matter of fact, the holding advocated by the dissenting opinion can be reached only by a substitution for the terms of the contracts executed of terms that are composed by the dissent and that are not the terms adopted by the parties to the contracts before us. The doctrine of construction of contracts advocated by the dissent is not properly applied here as the dissent would have it applied. For the above reasons, I concur in the majority opinion.

DISSENTING OPINION

DISNEY, dissenting:

The problem here is whether subsection 302 (g) of the Revenue Act of 1926 shall be so construed as to vitiate and nullify subsection (c) in this proceeding. The majority opinion has so construed it, erroneously, in my opinion. The gist of the reason for such construction by the majority opinion is the fact that the deceased received from an in- [fol. 37] surance company a form denominated a "Single Premium Life Policy. Insurance Payable at Death." The contention is, in effect, that because therein the words "insurance" and "insured" were used, that they must be construed in the usual acceptation of the terms, regardless of other language used, and that therefore the situation falls under subsection 302 (g), rather than under subsection (c). Faced by the fact of the issuance of the so-called life insurance policy simultaneously with and "in conjunction with" an annuity policy, without which the "insurance" would not have been written, the majority opinion in words agrees that the two policies must be construed in connection with each other, but in fact in the next breath insists upon a separation, upon the theory that although the two policies formed one contract, the insurance policy feature and the annuity feature were divisible elements, that the whole transaction was not an entire, but a severable or divisible contract, and that the annuity policy was a mere condition precedent to the insurance policy.

This is, I think basic error. That two such policies issued together do form one contract is almost, if not quite, elementary—and as above stated, this is not denied in the majority opinion. See Urwan v. Northwestern Life Insurance Co., 103 N. W. 1102; Schreiber v. German-American Hail Insurance Co., 45 N. W. 708; Timlin v. Equitable Life Assurance Society of United States, 124 N. W. 253. Moreover, language in a contract or deed is primarily and ordinarily to be construed as a term or covenant thereof and not as a condition precedent. Woodruff v. Woodruff, 16 Atl. 4; 44 N. J. E. 349; Detroit Union Railroad Depot & Station Co. v. Fort St. Union Depot Co., 87 N. W. 214.

In the face of this general principle of construction there is no justification, I think, for holding that the annuity feature was a condition precedent, rather than an indivisible

part of a contract. The citation by the majority of Legg [fol. 38] v. St. John, 296 U. S. 489, is on its face inapplicable, for it states (referring to the "supplementary contract" unsuccessfully sought to be incorporated into the principal contract): "But for all other purposes it is a separate obligation." This refers to other language of the decision which specifically points out that the supplementary contract was, as to the feature at issue, covered by language of the policy that: "No other provision of said policy shall be held or deemed to be a part hereof." Other citations as to cases involving "separate features which are clearly severable" are of course not in point here where the annuity feature was, on the contrary, clearly inseparable. That it is indivisible, inseparable from the life insurance feature, is demonstrated by the most effective of facts—that the life insurance feature would not have been written without the annuity feature. The company joined the two features. We can not with good logic treat them otherwise. It is impossible for me to discern how these two features can be severable, as the majority sever them. The annuity feature is no condition precedent, but a term, provision, or part of what the majority must perforce and does conclude is to be interpreted as a single contract. The doctrine of conditions means just what it says, that is, it entails a condition, a state of affairs or a fact upon which the existence of the contract depends, but an attempt to make one contract depend upon another contract as a condition precedent is merely to admit that the contracts form one, that additional provisions are agreed upon, and are to be construed together. One is not separate and a condition of the other, but each loses identity in the completed agreement. Thus, we see that there is no condition precedent entailed here, but a mere question of the proper interpretation of two terms of a contract, which under the ever prevalent rule must be considered as a whole to ascertain the intent of the parties. Welch v. Union Central Life Insurance Co., 78 N. W. 853; Mutual Life Insurance Co. v. New, 51 So. 61. But if we read the contract as a whole, how [fol. 39] can it be said that the insurance feature is independent when it depended completely upon the inclusion of the annuity feature without which the insurance company would not enter into a contract? Had the consideration or the annuity failed, such as by dishonoring of a check, can there be any doubt that the insurance company would have

immediately contended that the contract was an integer, indivisible and inseparable, and that they could not be held to the insurance feature alone? Yet to answer the query in the affirmative is to admit that this contract as a whole was not insurance, but was a hybrid, not to be construed merely as an insurance policy—which is what the majority opinion does by the expedient of separating the "insurance" policy and regarding it only. If joint construction of the two policies, as a whole, is required, however, obviously what has been said by us in Old Colony Trust Co., Executor, 37 B. T. A. 435, and upon the affirmation thereof by the Circuit Court, 102 Fed. (2d) 380, and in the authorities there cited, applies fully, and we have before us nothing different in essence and fact from the annuity with payment at death, involved therein, and involved in Chemical Bank & Trust Co. et al., Executors, 37 B. T. A. 535, for when the essential nature of the different situations is examined, the controlling fact in each is seen to be that an amount of money was placed with an insurance company with income reserved to the decedent and without the feature of true and usual insurance risk carried by the insurance company —for which reason such contracts were found not to be applicable to subsection (g).

Cooley on Insurance, vol. I, p. 80, says:

From what has been said it is evident that *the primary requisite essential to the existence of every contract of insurance is the presence of a risk of loss.* The insurer, in return for a consideration paid to him by the insured, assumes this risk, and wherever such risk exists and is as- [fol. 40] sumed by one of the parties to the contract, whatever form a contract may take, it is in fact a contract of insurance. Risk is essentially the subject of the contract. If there be no risk there can be no contract, and until the risk commences the contract does not attach. (Hart v. Delaware Ins. Co., 11 Fed Cas. 683.)

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The risk which is essential to a contract of insurance must not be so great as to be prohibitory of the enterprise in which it is encountered. There must, in order that there may be successful insurance, be a sufficiently large number exposed to the same risk to make it practicable and advantageous to distribute the loss falling upon a few. As indemnity against loss is at the foundation of insurance,

the business must be regarded as a system of distributing losses upon the many who are exposed to the common hazard. (Nye v. Grand Lodge A. O. U. W., 9 Ind. App. 131, 36 N. E. 429.) Out of the co-existence of many risks arises the law of average, which underlies the whole business of insurance. This is true, whether the insurance is on property or on lives. Life insurance especially is founded on the law of averages. The average rate of mortality is the basis on which it rests, and by spreading their risks over a large number of cases the companies calculate on the average with reasonable certainty and safety. (New York Life Ins. Co. v. Statham, 93 U. S. 24, 23 L. Ed. 789.)

Curry v. Washington National Insurance Co., 194 S. E. 825, says:

The definition of a contract of insurance imports the assumption of a risk by the insurer and the payment of a consideration therefor by insured.

The above clearly states the essential nature of life in- [fol. 41] surance. A contract which, instead of the insurance company assuming the risk of death of the insured, provides that the insured himself carries that risk, is patently violative of the above essential principle of insurance. Yet here that situation is plainly found. The applicant was not insurable because of age—so completely not insurable that a physical examination was immaterial and was not required. The facts found recite "* * * *provided satisfactory evidence of insurability is furnished* a life insurance policy may be issued in the absence of an annuity contract." [Italics supplied.] In that situation the applicant in effect said: "I will carry the risk. I will pay you, the insurance company, a sum of money over and above the single premium for the 'insurance policy,' sufficient that you, provided only that you invest the money paid you at your usual rates of return, will at all times have the funds with which to pay me an 'annuity' and upon my death pay my beneficiary a certain sum." It can not be denied, I think that the applicant was carrying the risk, for the annuity contract was required "due to the amount of risk involved, namely, the difference between the consideration and the death benefit." The applicant plainly supplied the money to absorb the risk, the difference between $17,941.80 single premium, and $20,000 death benefit, when she

paid $21,200. The $195.42 payable semiannually was less than 2 per cent upon the $21,200, and the company took not the slightest risk, except the risk that it might conceivably not earn so much as 2 per cent upon the $21,200—but that is patently an investment risk, and not the risk of having the "insured" die before paying in enough premiums to make the company safe. That is the insurance risk, which an insurance company assumes for the insured and can carry more safely than can he, because of the broad spread over many people. Contrary to the situation involved in true insurance, it was in nowise affected by an early death of the applicant, for the $20,000, and the money above that [fol. 42] amount, was already paid in, ever present in amount sufficient to pay the $20,000 and the annuity income agreed upon, dependent only upon rate of earning exceeding the small percentage required for the annuity payments. The very base and plinth of the whole theory of life insurance denies that life insurance risk is entailed therein. (The dividends which might be paid are immaterial, since they would be paid only upon earnings after reservation of a percentage greater than that required to pay the annuity income, and initial expenses, such as commissions paid, are immaterial, for they are no part of the risk assumed for the insured by the company. The same applies to the fact of surrender value in the "insurance" feature, for the amount remaining for protection of the annuity is decreased only proportionately with the decrease in liability thereon, since the same basis of mortality table applies to both features. The annuity contract, standing alone, involved risk, but when one with the "insurance" feature—which is what the company insisted upon—its risk was mathematically absorbed by the moneys paid in under the name of single premium.)

The ratio decidendi of Old Colony Trust Co. et al., Executors, supra, and the cases correlated therein was the lack in the contracts considered of the essential element of life insurance risk, as above set forth, and the lack of such expressions as "insurance" or "insured", though mentioned, was not the crucial point. Terms do not control and a phrase can not contradict reality. Stearns Co. v. United States, 291 U. S. 54. "The nature of the contract must be determined from its contents and not by its terminology." Physicians' Defense Co. v. O'Brien, 111 N. W. 396.

It seems to me that therein lies the basic error in the majority opinion, for because of the existence of the expressions "insurance" and "insured" in one part of the indivisible contract involved, the majority believe that we [fol. 43] should find that insurance is involved. It is true that reliance is placed in a sound principle of a statutory interpretation, to wit, the use of words in their ordinary sense. The majority opinion therefore says, in effect, that section 302 (g), because of reference to "insurance", involves any policy which bears the name of insurance. That principle of statutory construction however is patently subject to the other, just above expressed, that terms alone do not control, and the facts must be examined. Moreover, another principle of construction, coordinate if not more important, seems to be neglected by the majority opinion—the principle that legislative intent must be ascertained. No examination of that question appears in the majority opinion, yet in the interpretation of section 302 (g) in Commissioner v. Jones, 62 Fed. (2d) 496, we find the following:

> * * * It seems to us that the provisions of subdivision (g) relied upon by the Commissioner are to be interpreted in the light of the purpose to be effected in excluding from the gross estate insurance in the amount of $40,000 receivable by beneficiaries other than the estate * * *.

It seems obvious that the purpose of Congress in exempting $40,000 of life insurance payable to beneficiaries other than the estate was the same as the public policy involved in the statutes of many states exempting insurance in general for the wife or family; in other words, that Congress recognized a beneficent public policy in providing that insurance should form an estate for dependents and that by insurance, therefore, one could build up such an estate. Equally obvious, however, such public policy was not necessary in the case of one who did not need to build up an estate but already had funds with which he could not only pay for a single premium insurance policy, but could, if not insurable because of age or physical condition, pay in such an additional amount of money in a combination of [fol. 44] life insurance and annuity that the company would deal with him because it was financially safe, he having paid "the amount of the risk involved, namely, the difference between the consideration and the death benefit." Yet

under the majority opinion the benefit of section 302 (g) is extended to him and his estate escapes estate tax because he for a consideration costing more than insurance had obtained as a part of a contract the form of a life insurance policy, a contract which the company would not enter, requiring a different and broader agreement. The insurance company added a feature which the majority will not add.

I can not bring myself to believe that one subsection of this section of the revenue law should here be interpreted so as to render ineffective the other, but feel rather that the two subsections should be harmonized if possible and that we should arrive at a conclusion that subsection (g) is applicable only if subsection (c) is not violated in the facts, and not apply it merely because we find the word "insurance" in a contract which is, and was intended by the parties, as investment, as a contract of transfer of property with retention of income for life, of the very nature forbidden by subsection (c). Insurance does not have such effect. The contract here involved does, and I conclude that it is not insurance, but is a transparent device to use, in order to escape estate tax, the expression "insurance", though it is a part, and a part only, of a contract which, in the cases above cited, has been refused recognition as basis for exemption. It is apparent that in this contract, as stated in Old Colony Trust Co. et al., Executors, supra, "the obligations of the company were such that the investment feature predominates and gives character to the contract,"

That the revenue act distinguishes between policies involving mere investment and those entailing insurance is shown in Helvering v. Illinois Life Insurance Co., 299 U. S. 88. Therein was considered "reserves required by law", as deductions, in part, from gross income under section 203 [fol. 45] (a) (2) of the Revenue Act of 1928, and it was held that such reserves must directly pertain to life insurance, and do not include "survivorship investment funds" accumulated from premiums on 20-payment life policies, to be paid to surviving policyholders; and the Court stresses the fact that under the latter feature of the policy "the company's liabilities on account of the investment funds are independent of these attributable to life insurance risks." In other words, investment risks are not within the category of life insurance for the purpose of the revenue

act, even though covered by a policy labeled one of insurance. Such a contract, involving survivorship investment funds, in called insurance, ordinarily known as tontine insurance. The Court relied upon its previous decision to the same general effect in Helvering v. Inter-Mountain Life Insurance Co., 294 U. S. 686. Commenting upon Helvering v. Illinois Life Insurance Co., supra, Paul and Mertens, Law of Federal Income Taxation, §36.11 (supplement) says: "A broad definition of the term *life* insurance was rejected by the Court in reversing the lower court * * *." Both cases are noticed by the Circuit Court in Old Colony Trust Co. et al., Executors, supra.

Turner, Mellott, Hill, and Opper agree with this dissent.

[fol. 46] BEFORE UNITED STATES BOARD OF TAX APPEALS

DECISION—Filed May 26, 1939

Pursuant to the determination of the Board, as set forth in its report promulgated May 25, 1939, it is ordered and decided: That there is no deficiency in estate tax.

(Signed) Eugene Black, Member.

Entered May 26, 1939.

[fol. 47] IN UNITED STATES CIRCUIT COURT OF APPEALS, THIRD CIRCUIT

PETITION FOR REVIEW AND ASSIGNMENTS OF ERROR—Filed August 18, 1939

To the Honorable Judges of the United States Circuit Court of Appeals for the Third Circuit:

Now comes Guy T. Helvering, Commissioner of Internal Revenue, by his attorneys, Samuel O. Clark, Jr., Assistant Attorney General, J. P. Wenchel, Chief Counsel, Bureau of Internal Revenue, and Ralph F. Staubly, Special Attorney, Bureau of Internal Revenue, and respectfully shows:

I

That he is the duly appointed, qualified and acting Commissioner of Internal Revenue, appointed and holding office by virtue of the laws of the United States; that Pius P. Kel-

ler, residing at 207 S. Aiken Avenue, Pittsburgh, Pennsylvania, and Marcella V. Keller, residing at 6348 Douglas Street, Pittsburgh, Pennsylvania, are the duly appointed, qualified and acting executors of the Estate of Anna M. Keller; that said Anna M. Keller died a resident of Pittsburgh, Pennsylvania, on March 23, 1936; that the Estate Tax Return, Form 706, made for the estate of the decedent, was filed with the Collector of Internal Revenue for the Twenty-third District of Pennsylvania, whose office is located at Pittsburgh, Pennsylvania, which is within the jurisdiction of the United States Circuit Court of Appeals for the Third Circuit.

The Court in which the review of this proceeding is sought is the United States Circuit Court of Appeals for the Third Circuit.

[fol. 48] II

The nature of the controversy is as follows, to wit:

The Estate Tax Return filed on behalf of decedent's estate disclosed a tax liability of $21,609.68. The decedent during her lifetime, on December 31, 1934, acquired from The Equitable Life Assurance Society of the United States, and there was issued to her by said society on said date, a certain contract designated a single-premium life insurance policy in the principal amount of $20,000.00, for a premium of $17,941.80, which said contract or policy was issued in conjunction with a life annuity contract for the payment of an annuity of $195.42 payable every six months at a cost of $3,258.20.

In the Estate Tax Return filed for the decedent's estate, the proceeds payable under and pursuant to the contract or insurance policy aforesaid, were included in the decedent's gross estate for the purpose of the tax, as insurance or insurance proceeds payable to the beneficiary named in said contract or policy. The estate claimed an exclusion or exemption of $40,000.00 with respect to said proceeds, pursuant to the provisions of Section 302 (g) of the Revenue Act of 1926, upon the theory that such monies constituted insurance within the purview of said section of the statute aforesaid.

Under date of January 29, 1938 the Commissioner of Internal Revenue mailed a notice to the executors aforesaid, asserting a deficiency in estate tax in the amount of $3,243.64.

In determining the deficiency the Commissioner disallowed the exemption claimed with respect to the proceeds paid to the beneficiary named in said contract or policy of insurance and included said proceeds in the decedent's gross estate as the subject of a transfer made in contemplation of and intended to take effect in possession or enjoyment at or after the decedent's death, pursuant to the provisions of [fol. 49] Section 302 (c) of the Revenue Act of 1926.

Under date of April 29, 1938 the executors aforesaid filed a petition with the United States Board of Tax Appeals for a redetermination of the deficiency in the estate tax, as determined by the Commissioner. After the answer of the Commissioner was duly filed, the case was submitted to the Board for decision. The interlocutory opinion and decision of the Board was promulgated May 26, 1939 and the final order of the Board, redetermining the deficiency, was entered May 26, 1939, wherein it was ordered and decided that there is no deficiency in estate tax.

The Board of Tax Appeals held that the proceeds paid to the beneficiary named in said contract or policy of insurance constituted insurance payable to a specific beneficiary within the purview of Section 302 (g) of the statute aforesaid, and that the estate was therefore entitled to the exemption of $40,000.00 with respect thereto.

III

The Commissioner of Internal Revenue being aggrieved by the conclusions of law contained in the decision of the Board of Tax Appeals and by its order of redetermination, desires to obtain a review thereof by the United States Circuit Court of Appeals for the Third Circuit.

The Commissioner's assignments of error are as follows:

1. The Board of Tax Appeals erred in holding and deciding and finding as a fact that the so-called single-premium life insurance policy issued in conjunction with the life annuity contract, is a life insurance policy within the purview of Section 302 (g) of the taxing statute; there being no substantial evidence to support such finding of fact.

[fol. 50] 2. The Board of Tax Appeals erred in not holding and deciding and finding as a fact that the so-called single-premium life insurance policy issued in conjunction with the life annuity contract, was not a policy of life insurance

within the purview of the statute, as established by the facts adduced.

3. The Board of Tax Appeals erred in not holding and deciding that the disposition made by the decedent of the proceeds arising out of the so-called life insurance policy constituted a transfer in contemplation of and intended to take effect in possession or enjoyment at or after the decedent's death.

4. The Board of Tax Appeals erred in that its decision is not supported by the evidence and is contrary to law.

5. The Board of Tax Appeals erred in entering its final order of redetermination that there is no deficiency in estate tax.

6. The Board of Tax Appeals erred in failing and refusing to enter its final order of redetermination that there is a deficiency in the estate tax in the amount of $3,243.64, as determined by the Commissioner, instead of no deficiency.

Wherefore, the Commissioner petitions that the decision of the Board of Tax Appeals be reviewed by the United States Circuit Court of Appeals for the Eighth Circuit, that a transcript of the record be prepared in accordance with law and with the rules of said Court and transmitted to the Clerk of said Court for filing, and that appropriate action be taken to the end that the errors complained of may be reviewed and corrected by said Court.

[fol. 51] (Sgd.) Samuel O. Clark, Jr., Assistant Attorney General. R. (Sgd.) J. P. Wenchel, Chief Counsel, Bureau of Internal Revenue. R.

Of counsel: Ralph F. Staubly, Special Attorney, Bureau of Internal Revenue.

Duly sworn to by Ralph F. Staubly. Jurat omitted in printing.

[fol. 52] In United States Circuit Court of Appeals

Notice of Filing Petition for Review—Filed Aug. 23, 1939

To Ferdinand P. Weil, Esq., Frick Building, Pittsburgh, Pennsylvania:

You are hereby notified that the Commissioner of Internal Revenue did, on the 18th day of August, 1939, file with the

Clerk of the United States Board of Tax Appeals, at Washington, D. C., a petition for review by the United States Circuit Court of Appeals for the Third Circuit, of the decision of the Board heretofore rendered in the above-entitled case. A copy of the petition for review and the assignments of error as filed is hereto attached and served upon you.

Dated this 18th day of August, 1939.

Signed J. P. Wenchel, Chief Counsel, Bureau of Internal *Review*. R.

Personal service of the above and foregoing notice, together with a copy of the petition for review and assignments of errors mentioned therein, is hereby acknowledged this 19 day of August, 1939.

(Sgd.) F. P. Weil, Weil, Christy & Weil, Attorneys for Respondents on Review.

spt 8-17-39.

[fol. 53] IN UNITED STATES CIRCUIT COURT OF APPEALS

NOTICE OF FILING PETITION FOR REVIEW—Filed Aug. 23, 1939

To Marcella V. Keller, Executor of the Estate of Anna M. Keller, 6348 Douglas Street, Pittsburgh, Pennsylvania:

You are hereby notified that the Commissioner of Internal Revenue did, on the 18th day of August, 1939, file with the Clerk of the United States Board of Tax Appeals, at Washington, D. C., a petition for review by the United States Circuit Court of Appeals for the Third Circuit, of the decision of the Board heretofore rendered in the above-entitled case. A copy of the petition for review and the assignments of error as filed is hereto attached and served upon you.

Dated this 18th day of August, 1939.

Signed J. P. Wenchel, Chief Counsel, Bureau of Internal Revenue. R.

Personal service of the above and foregoing notice, together with a copy of the petition for review and assignments of errors mentioned therein, is hereby acknowledged this 19 day of Aug., 1939.

(Sgd.) Marcella V. Keller, Respondent on Review.

spt 8-17-39.

[fol. 54] IN UNITED STATES CIRCUIT COURT OF APPEALS

NOTICE OF FILING PETITION FOR REVIEW—Filed Aug. 23, 1939

To Pius P. Keller, Executor of the Estate of Anna M. Keller, 207 S. Aiken Avenue, Pittsburgh, Pennsylvania:

You are hereby notified that the Commissioner of Internal Revenue did, on the 18th day of August, 1939, file with the Clerk of the United States Board of Tax Appeals, at Washington, D. C., a petition for review by the United States Circuit Court of Appeals for the Third Circuit, of the decision of the Board heretofore rendered in the above-entitled case. A copy of the petition for review and the assignments of error as filed is hereto attached and served upon you.

Dated this 18th day of August, 1939.

Signed J. P. Wenchel, Chief Counsel, Bureau of Internal Revenue. R.

Personal service of the above and foregoing notice, together with a copy of the petition for review and assignments of errors mentioned therein, is hereby acknowledged this 19 day of August, 1939.

(Sgd.) Pius P. Keller, Respondent on Review.

spt 8-17-39.

[fol. 55] BEFORE UNITED STATES BOARD OF TAX APPEALS

STATEMENT OF EVIDENCE—Filed November 27, 1939

The following is a statement of evidence in narrative form in the above-entitled cause. This cause came on for hearing before the Honorable Eugene Black, Member of the United States Board of Tax Appeals, on November 8, 1938, at Pittsburgh, Pennsylvania. Ferdinand T. Weil, Esq., appeared for the petitioners (respondents on review), and J. P. Wenchel, Chief Counsel, Bureau of Internal Revenue, by Paul E. Waring, Esq., appeared for the Commissioner of Internal Revenue.

Thereupon there was offered and received in evidence a stipulation of facts entered into between the parties, together with Exhibits "A" to "I", inclusive, as hereinafter referred to, which said stipulation of facts, exclusive of said

exhibits, is incorporated herein and made a part hereof by this reference.

STATEMENT AS TO EXHIBITS

Exhibit "A" of the stipulation of facts is a copy of the Federal Estate Tax Return made on behalf of the decedent's estate by which it was shown that the estate included in the decedent's gross estate the amount of the proceeds paid to the beneficiary pursuant to the policy of insurance issued to the decedent as the insured by The Equitable Life Assurance Society of the United States, designated as single-premium life policy No. 9652636, and that the estate claimed that such proceeds were subject to be excluded from the gross estate by reason of the $40,000 exemption or exclusion allowed with respect to insurance proceeds under Section 302 (g) of the Revenue Act of 1926, as insurance payable to a specific beneficiary other than the decedent's estate. [fol. 56] Exhibit "B" of the stipulation of facts is a copy of the deficiency notice mailed to the executors under date of January 29, 1938, a copy of which is attached to the petition, and the same is incorporated herein and made a part hereof by this reference.

Exhibit "C" of the stipulation of facts is a photostatic copy of the life annuity single-premium non-participating policy or contract, No. 9652635, issued to the decedent, Anna M. Keller, as the annuitant, by which it was shown that said policy or contract was issued December 30, 1934 and provided for the payment of an annuity of $390.84, payable in the sum of $195.42 every six months; that said policy was issued upon the payment of a single premium of $3,258.20; and that at the date said contract or policy was issued, the annuitant was 74-¾ths years of age.

Photostatic copies of the aforesaid policy or contract, by leave of the Court, are filed herewith as physical exhibits.

The said contract or policy contains the following sentence:

"The Contract. This policy, and the application therefor, a copy of which is endorsed hereon or securely attached hereto, constitute the entire contract between the parties."

Exhibit "D" of the stipulation of facts is a photostatic copy of the single-premium life policy No. 9652636 issued

to Anna M. Keller, the decedent, as the insured, in the principal amount of $20,000.00, by which it was shown that said policy was issued December 30, 1934 to the insured at the insurable age of 75 years; that the policy was issued upon the payment of a single premium of $17,941.80; that the policy was issued upon a standard form of the insurance company; that the policy was made payable to the insured's daughter, Marcella V. Keller, as the beneficiary and that [fol. 57] upon April 1, 1935 the beneficiary was changed by endorsement upon the policy to read "Marcella V. Keller, daughter, if living, if not living, to Marie A. Lamb and Pious P. Keller, children, in equal shares or survivor"; that attached to the policy and made a part thereof is a copy of the application for the issuance thereof made by Anna M. Keller dated November 28, 1934; that under the terms and provisions of the policy it possessed a loan and cash surrender value upon the expiration of one year of $814.00 per thousand, upon the expiration of the second year, $825.00 per thousand, upon the expiration of the third year, $836.00 per thousand, upon the expiration of the fourth year, $847.00 per thousand, and upon the expiration of the fifth year $859.00 per thousand, with increasing amounts for succeeding years; and that under the terms and provisions of the policy the decedent reserved the right to change the beneficiary or assign the same.

Photostatic copies of the aforesaid policy, by leave of the Court, are filed herewith as physical exhibits.

The said contract or policy contains the following sentence:

"The Contract. This policy, and the application therefor, a copy of which is endorsed hereon or security attached hereto, constitute the entire contract between the parties."

Exhibit "E" of the stipulation of facts is a photostatic copy of the death certificate issued upon the death of the decedent, Anna M. Keller, by which it was shown that death resulted from cerebral hemorrhage of one-half day duration and that a contributing cause of importance was la grippe of fourteen days duration.

Exhibits "F" and "G" of the stipulation of facts, are letters dated December 21, 1937 and January 6, 1938, which are in the form, words and figures as follows:

[fol. 58] "MT-ET-C1-5938-23rd Pennsylvania.
Estate of Anna M. Keller.
Date of Death—March 28, 1936.

Dec. 21, 1937.

The Equitable Life Assurance Society of the United States,
393 Seventh Avenue, New York, New York.

SIRS:

There is included in the above-named estate a single premium life insurance policy No. 9,652,636 in the face amount of $20,000.00, age at date of issuance 75, and on which a single premium of $17,941.80 was paid.

In view of the information of record please advise this office if your company would at the time the above policy was issued, write this type of policy for a person 75 years of age without writing an annuity contract on the life of the insured.

There is enclosed for your reply a franked envelope which requires no postage.

Respectfully, (Signed) D. S. Bliss, Deputy Commissioner.

Enclosure: Envelope.
JFM/BER.

THE EQUITABLE LIFE ASSURANCE SOCIETY
OF THE UNITED STATES
393 Seventh Avenue, New York
Thomas I. Parkinson, President
Policy Issue and Service Department
Tel. Penn. 6-7000 Ext. 268

[fol. 59] W. G. Schelker, Vice-President.
W. M. Donohue, Superintendent.

January 6, 1938.

Mr. D. S. Bliss, Deputy Commissioner, Miscellaneous Tax Unit, Bureau of Internal Revenue, Washington, D. C.

DEAR SIR:

Policy 9652,636—Mrs. Anna M. Keller

In response to your letter dated December 21, 1937, we wish to inform you that policy 9,652,636 was issued in conjunction with Life Annuity policy 9,652,635.

In reply to the second paragraph of your letter, we wish to inform you that the Society would not have issued policy 9,652,636 to the insured at her attained age of seventy-five without issuing a Life Annuity contract in conjunction with the Ordinary Life policy.

We presume no additional information is desired.

Yours very truly, (Signed) W. G. Schelker, Vice-President."

McG: 26.

Exhibits "H" and "I" of the stipulation of facts are copies of letters dated November 1 1938 and November 3, 1938, which are in the form, words and figures as follows:

Nov. 1, 1938.

"Mr. W. G. Schelker, 2nd Vice-President, Equitable Life Assurance Society, 393 Seventh Avenue, New York City.

[fol. 60] DEAR SIR:

As counsel for the estate of Anna M. Keller, deceased, we have a tax case before the U. S. Board of Tax Appeals Monday or Tuesday, the 7th or 8th instant, here in Pittsburgh. The case involves two of your contracts, one being an annuity policy taken out by the decedent, Anna M. Keller, being your No. 9652635, and the other being a single-premium whole life policy on the life of the same decedent, being your No. 9652636.

Mr. Paul E. Waring, attorney for the Government tax authorities, has requested us to procure from your company the data specified below, which, incidentally, we also desire to have for use in the said tax case.

For your information the tax issue involved is this: In 1934 Mrs. Keller, then 74 years of age, executed with your company a whole life insurance contract for $20,000, paying a single premium of $17,941.80, with certain of her children named as beneficiaries. On the said date she also executed with your company a separate annuity contract, paying a single premium of $3,258.20, on which she was to receive an annual payment of $390.84.

In listing the $20,000 life insurance in the federal estate tax return, the taxpayer claimed that the $20,000 proceeds of the policy paid by your company came within the $40,000 exemption of Section 302 (g) of the Revenue Act. The Internal Revenue Department on the other hand, claimed that

the exemption should not apply, on the grounds that the life insurance policy, although a separate contract of insurance, should not be looked upon as a life insurance contract, but because the annuity policy was taken out the same day the two contracts, although separate, should be looked upon as one transaction, and constituted an investment instead of separate contracts of life insurance and annuity.

[fol. 61] Among the chief reasons the tax officials have given for taking this view is that the insurance carrier really had no risk, and that they would have refused to have written the policy on the life of Mrs. Keller at an age over 70, especially without a physical examination, had she not also taken out the annuity contract, and that inasmuch as your company required the annuity contract before being willing to issue the life insurance contract, the two must be looked upon as one transaction. We, on the other hand, have insisted that even though we admit that your company would not have issued the life insurance policy without the insured also taking out the annuity policy, nevertheless this was a condition precedent to issuing the life insurance policy and once it was issued it constituted a life insurance contract and must so be considered in connection with the exemption claimed. We also maintain that the insurance carrier does have a risk.

The following is the specific information which the attorney for the Government insists upon having:

(1) It will be noted that if the single life insurance premium of $17,941.80 be added to the single annuity premium of $3,258.20, the total sum amounts to $21,200 or exactly $1200 more than the $20,000 face amount of the life insurance policy. The Government wishes to know from your books or records to what, specifically, the $1200 was applied, i. e., how much for commissions, how much for overhead, etc.

(2) A transcript from your books or records, or a statement as to what your books or records show as to what was done with or the application of the reserve set aside on each policy at the time the policy was taken out, one year later, and at the time of the decedent's death which was a year and a few months after the taking out of the policy. In giving a transcript of your records or a statement therefrom as to what your books or records show, kindly state [fol. 62] whether these two separate contracts were treated

on your books and records as one contract or one transaction or listed separately and individually as constituting two separate contracts.

(3) A statement showing the method used by your company in computing the life insurance and annuity payments. In connection therewith please state whether the life insurance premium and the annuity payments were the same as would have been incident to each policy had they been issued separately without the other, or not. For example, if your company would have been willing to have written the life insurance policy in question without the annuity, would the premium have been the same at the age of Mrs. Keller when she took out the policy, and also, had she taken out the annuity policy separately would the amount of annuity which she was to receive from the principal paid have been the same on the policy in question had she not at the same time taken out the life insurance policy?

(4) A statement as to the amount of dividends paid during the existence of the insurance policy, and the amount of annuity payments paid under the annuity policy.

(5) What was the life expectancy of the insured at the time she took out the life insurance policy according to your life insurance tables, and also her life expectancy at the time she took out her annuity policy according to your annuity schedule.

(6) Why the life insurance policy was on the "whole" life of the insured instead of on her "ordinary" life, and the difference between whole life and ordinary life, and the company's use thereof on policies.

Whereas we would have been willing to have merely had your statement in answer to the above questions, counsel for the Revenue Department insists that the answers [fol. 63] to items (1), (2), and (4) be taken from your actual books and records, and have even stated that if this be not done they will attempt to subpoena you personally with a subpoena duces tecum to bring in your books and records showing these items. Your Pittsburgh office has been most courteous and accommodating in the premises and we, of course, do not wish to have you bothered with any attempts on the part of the Government authorities in connection with any subpoena, and hope that you will be

able to furnish the information above requested without too much trouble and inconvenience on your part.

In view of the short time before this case is to be heard, and inasmuch as we have been unable to find any decision of the courts or of the Board of Tax Appeals on the exact question involved in this case, we shall greatly appreciate your forwarding the above requested information just as soon as you possibly can.

Very truly yours,

(Signed) Weil, Christy & Weil.

FW-R-1295-99

THE EQUITABLE LIFE ASSURANCE SOCIETY OF THE UNITED STATES

393 Seventh Avenue, New York

Department of Policy Claims, Legal Reference Division

November 3, 1938.

Messrs, Weil, Christy & Weil, 720-724 Frick Building, Pittsburgh, Pennsylvania.

GENTLEMEN:

Re: Anna M. Keller, deceased, Policies Nos. 9652,635—and 9652,636.

[fol. 64] Mr. Charles A. Woods, Vice President and General Counsel of The Edward A. Woods Company, General Agent for the Society in Pittsburgh, has forwarded your letter of November 1, addressed to Mr. W. G. Schelker, to the Home Office. Mr. Schelker has asked us to look into the questions presented in your letter. Our Actuary's Department has given us most of the information in reply to your questions, inasmuch as the subjects raised are largely actuarial in nature.

Mr. Woods in his letter ask that we call to your attention any other cases involving this question which have come to the attention of the Society but not reported in the reported decisions and rulings. We do not know of any cases involving this question which has been passed upon by the Board of Tax Appeals or by the Courts.

In your letter you ask that our answers to Questions (1), (2), and (4) be taken from our actual books and records. While in some instances the information given is

from our actual books and records, in other instances it is impossible to give you the information from our books and records, because there are no actual bookkeeping entries for the transactions. In answering these questions, we have attempted to comply with your requests as nearly as possible and at the same time clearly and simply set forth the actual history of the case in so far as our records are concerned.

With respect to the first question presented by you, our books and records do not reflect the application of the $1200 excess. Each individual policy, namely, the single premium insurance policy and the single premium annuity contract, must stand certain direct expenses, as set forth below, which are a percentage of the premium on each contract:

[fol. 65]

	Single Premium Insurance Contract		Single Premium Annuity Contract	
Commission	5.0%		3.5%	
Expense Allowance to General Agent	.5		.5	
Premium Tax	2.0		—	
	7.5%		4.0%	
	× 17,941.80		× 3,250.20	
	= 1,345.65	+	130.33	= 1,475.97

With respect to Question No. 2, our answer would be as follows:

You ask that the answer to this question be in the form of a transcript from our books or records, if possible. This information cannot be obtained from bookkeeping entries, and we believe that your purpose can best be served by a statement as to what our records or books show with respect to the disposition of the single premiums and the setting up of the reserves for each of the above contracts in our Annual Statement.

The consideration received from the insurance contract, Policy No. 9652,636, was credited to the account, "First year insurance premiums, Ordinary," whereas the consideration received for the annuity contract, Policy No. 9652,635 was credited to the account, "First year annuity

premiums, Ordinary." The funds so received thereupon were merged with the general funds of the Society. Compensation was paid to our agent with respect to such contracts. Compensation paid with respect to the insurance contract was charged to the account, "Commissions on first year insurance premiums, Ordinary," whereas the compensation paid with respect to the annuity contract was [fol. 66] charged to the account, "Commissions on first year annuity premiums, Ordinary."

At December 31, 1934 the Society, in determining its liability with respect to outstanding contracts, included in its Annual Statement to the Superintendent of Insurance of the State of New York under the heading, "Not present value of all the outstanding policies in force on December 31 of current year, as computed on the following tables of mortality and rates of interest, viz: '3. American Experience Table at 3% on issues of 1895 and after'," the amount of $16,580. as the net present value of the insurance policy. It also included under the heading, "5. Net present value of annuities (including those in reduction of premiums), viz: Combined Annuity Table (1st modification) at 3¾%," the amount of $3021, as the net present value of the annuity contract. Similar items were included in the corresponding annual statement at December 31, 1935 in the following respective amounts:

Insurance	$16,760
Annuity	2,900

At the time the notice of decedent's death was received at the Home Office, an entry was included in the Cancellation List for policies terminated by death indicating the termination of the insurance policy, and this list was used as the basis for marking the various records maintained in the Society's office with respect to the status of that policy. A similar entry with respect to the annuity contract was included in the Cancellation List for annuity contracts terminated by death, and the information on this record was similarly used.

At the time of the decedent's death, the death benefit provided by the insurance policy was charged to the account, "Death Claims, Ordinary." No benefit at death was provided by the annuity contract, and there was conse- [fol. 67] quently no entry in the books of account at the time of death with respect to that contract.

Our answer to Question No. 3 would be as follows:

The single premium charged for Policy No. 9652,636, that is, $17,941.80, is twenty times the single premium per thousand dollars of whole life insurance at age 75, that is $897.09. The single premium of $897.09 is computed from the net premium based on the American Experience Table of Mortality at 3% interest with a proper loading for expenses. The mortality table and loading formula used are consistent with the basis of rates for single premium whole life insurance at all other ages.

The single consideration collected on Policy No. 9652,635, that is, $3258.20, is based on the American Annuitants Select Male Table of Mortality at 3¾% interest, modified for female lives. The net consideration required to provide the semi-annual income of $195.42 according to this table was loaded for expenses.

The Society would not have considered the issuance of life insurance at age 75 except in combination with an annuity contract or as a conversion from a group certificate. However, the basic rate at age 75 is consistent with the rate chargeable at the younger ages where, provided satisfactory evidence of insurability is furnished, a life insurance policy may be issued in the absence of an annuity contract. The consideration charged for the annuity contract would have been the same if no life insurance had been purchased at the time.

Our answer to Question No. 4 would be as follows:

For your use, we are enclosing an original and duplicate of a statement showing the dividends disbursed by the Society in connection with Policy No. 9652,636. With respect to the annuity payments made under Policy No. 9652,635, our records show that we made two semi-annual income pay- [fol. 68] ments in the year 1935. Each semi-annual payment amounted to $195,42. Our records do not indicate that any other payments were made under this contract and no other payments are to be made, in view of the fact that the contract terminated at the death of the annuitant on March 28, 1936. Inasmuch as this annuity contract was on a non-participating basis, no dividend disbursements were made by the Society.

Our answer to Question No. 5 would be as follows:

On the basis of the mortality table used to compute the premium under Policy No. 9652,636, the expectation of life at age 75 is 6.3 years.

According to the mortality table forming the basis for the annuity rate under contract No. 9652,635, the expectation of life of a female age 73¾ is 10.5 years.

Our answer to Question No. 6 would be as follows:

The term "Ordinary Life" is the designation applied to a life insurance policy under which premiums are payable throughout the entire lifetime of the insured (whether annually, semi-annually, quarterly or monthly). Where the premium for a life insurance policy under which the proceeds are payable at the death of the insured, whenever that may occur, is paid in a single sum at issue, the policy is referred to as a "single premium whole life policy."

We trust that the above information is what you wish in this case in reply to the inquiries, and we would appreciate very much your informing us the decision of the United States Board of Tax Appeals in this case.

Yours very truly, (Signed) L. D. Fitzgerald, Assistant Superintendent."

SAM:LMT.

[fol. 69] Thereupon, FREDERICK J. STEVENSON, called as a witness on behalf of the petitioners (respondents on review), having been first duly sworn, testified as follows:

Direct examination.

I am assistant to the treasurer of the Edward A. Woods Company, general agent of the Equitable. I have been with the company for seventeen years. I have held that position about two years. I teach the principles of life insurance at the University of Pittsburgh, and have for five years. It is my duty with the Edward A. Woods Agency to be familiar with the types of policies that an agent issues for the Equitable Company. I am familiar with the life insurance policy such as is involved in this case, on the life of Anna M. Keller, No. 9652636. There is no difference whatever between the form of that single-premium of life insurance

policy and the regular or any other single-premium life insurance policy that the company wrote at that time. It is a standard New York policy. And that is the life insurance policy, the single-premium life insurance policy which the company wrote, the type of policy, whether there was any other policy or any other annuity or anything. The type of policy that is involved in this case, being an annuity policy, and this particular one being an annuity granted to Anna M. Keller, being 9652635, is the standard annuity policy which our company wrote at that time. That is the same standard annuity policy that would be written at that time whether there was any life insurance contract or not. The premiums on the respective policies are based upon the standard tables, the American Experience Table of Mortality for the life insurance policy, and the standard annuity policy for the annuity policy. There are different tables for each type of policy. In connection with the policy, life insurance policy, executed with Anna M. Keller on this particular life insurance policy, the company accepted in lieu of medical examination, the issuance of a life insurance [fol. 70] policy, since through the issuance of a life annuity, the company had a partial hedge against loss due to premature death. Because of the amount of risk, the difference between the consideration and the death benefit, the company would not write at that time a life insurance policy on Mrs. Keller at the age of seventy-four and a half, or seventy-four and three-quarters, without requiring an annuity contract as a condition precedent. The issuance of that contract on the same date as the insurance and execution of the life insurance policy did not eliminate the risk. When I say "hedging it" I mean instead of eliminating it, it reduced the risk.

"Q. Now, in the opening statement of counsel for the Government, there was a statement that there was twelve hundred dollars more received by the Equitable Company of both annuity and the premium on the life insurance added together than the $20,000.00 face amount of the life insurance policy. Will you state whether that $1200 represented a profit, or just what was that?

"A. That $1200.00 is called 'loading' and it is for the purpose of paying commissions to the general agent and the special agent, as well as premium taxes, the exact amounts I believe are in the letter which you presented.

"Q. Now, it was stated in the opening statement, that the Equitable Company had no risk. Was this policy found profitable, a life insurance policy of this type, where an annuity policy was a condition precedent, was that found so profitable to the company that it continued it?

"A. It was not profitable. The basis on which we issued those policies was changed so that instead of their having been collected as $600.00, as was the case here, or, rather, $1200.00, the amount was raised to $2000.00 subsequently, [fol. 71] and then later, the issuance was made conditional upon medical examination."

I believe those changes were required in the increasing of the premium and in the requirement of physical examination because the company had too great a risk in the method they had operated at the time of these two policies. My agency or the Equitable Company never considered these two contracts, the standard form of life insurance, and the standard form of annuity contract, taken out on the same day and if the annuity contract was required as a condition precedent before the company would write the life insurance policy, as one transaction. They were separate contracts. From the time the two policies were written, they were handled by the Equitable Company as two separate transactions. Had Mrs. Keller, on that same date, asked for that same type of annuity contract without a life insurance contract, the company would have issued to her that very same annuity contract without any life insurance.

Cross-examination.

This type of contract is called by salesmen the 106 per cent combination. It is called by the salesmen 106 per cent combination because the combined, the two contracts, the single-premium life insurance policy and the single-premium annuity, required in lieu of medical examination, the total payment, the total consideration of 106 per cent of the face amount of the life insurance policy.

"Q. * * * Now, Mr. Stevenson, the Equitable Life Assurance Company would have issued a separate life insurance policy to Mrs. Keller, if she had been able to qualify on a physical examination?

"A. A single premium life policy?

"Q. That is right.

"A. Subject to medical examination?

[fol. 72] "Q. That is right. * * *

"A. You mean at her age?

"Q. At her age.

"A. I cannot answer that question. The rate book carries the rate for single premium whole life policy up to age seventy. Whether the company at that time issued single premium whole life insurance at ages above seventy, I cannot say, I don't know."

Assuming that they would have issued such a policy, there would have been no difference between that type of policy and the policy we have in question, what we call a life policy in this particular case. The rates would have been identically the same. But where the insurance company waived the examination, it was absolutely necessary that an annuity contract be taken out. In regard to the words I used, "partial hedge", in connection with the $1200 item, I should say partial hedge, because if Mrs. Keller had died the following day, the company would have lost money. Therefore, there could not have been a complete hedge. The company would have lost money because the total of the commissions paid to the general agent, subagent, together with the taxes, would have amounted to more than $1200.00.

"Q. I show you a letter, which is Exhibit I in this case, addressed to Messrs. Weil, Christy & Weil, signed by L. D. Fitzgerald, Assistant Superintendent of the Equitable Life Assurance Society of the United States, which sets forth the various items which go to make the payment of $1200.00, and ask you if there was any payment in excess of $1200.00 itemized in that schedule, that schedule being the allocation of all costs in regard to both the life and annuity contracts, and ask you if you want to change your testimony?

"A. I would add one item. I would add the item of general overhead expense, the expense of the issuance of the policy. That is the cost of preparing and issuing the policy, [fol. 73] the delivery, and later apportionment payment of dividends on the policy during its duration.

"Q. Except for the allocation of overhead on the part of the insurance company, they always had on hand, insofar as these two policies are concerned, $20,000.00, did they not, from the date the policy was issued until the date of death?

"A. I cannot answer that question.

"Q. I want to know what portion of the $20,000.00 was this company not protected on the very next day after this policy was written.

"The Witness: I am not an actuary, and I do not believe that Mr. Weil intended that I speak for the Equitable. I am speaking for and on behalf of the Edward A. Woods Company, the agency through whom the policy was issued, but I would not want any statement of mine construed as coming from an actuary. The statements which I am making are based on my knowledge of these contracts. Perhaps a little more knowledge than an agent has, because I have made it my business to know life insurance and annuities, plus my knowledge of the letter written by our home office by Mr. Fitzgerald, in reply to Mr. Weil's letter."

It is not a fact that in the ultimate result, there was one contract, forgetting the form of two separate policies, the substance of the transaction is not one contract, in my opinion as an insurance expert, for the reason—because one contract could have been terminated without the termination of the other. In other words, the life insurance could have, one, three, five years later, been surrendered for its cash value and the annuity could have remained as an annuity for the balance of Mrs. Keller's lifetime.

"Q. Insofar as the issuance of these two policies was concerned on the dates they were issued, for all purposes, they [fol. 74] were one contract, one could not have been issued without the other, is that right?

"A. That is true; one could not have been issued without the other, since the annuity was accepted in lieu of medical examination."

Mrs. Keller could not have cancelled the annuity contract and kept the life insurance policy. A life annuity contract has no termination except by death of the annuitant. It is a separate annuity. The single-premium life insurance policy has a cash surrender value and may be terminated at any time by the one cancelling and receiving the cash value. The life annuity contract can never be terminated except by death of the annuitant.

"Q. Now, I want to know how the Equitable Life Assurance Society, in your opinion, can lose money on a combination policy known as 106 per cent combined?

"A. The Equitable Life Assurance Society received $21,200.00 on or about December 30, 1934, in return for which it contracted to pay to Mrs. Keller an income for life, and to pay her named beneficiary $20,000.00 at death. During the period from the issuance of the contract until the death of Mrs. Keller, the Equitable Life Assurance Society had certain expenses to pay so that it could maintain those contracts in force and ultimately pay $20,000.00.

Those expenses consisted of first, commissions to the subagent; second, commissions to the general agent; third, premium taxes; fourth, general overhead expenses. All of those expenses to be met out of this $1200.00 loading excess of consideration over ultimate death benefits.

In assuming the responsibility to make that payment, the Equitable Life Assurance Society assumed the $1200.00 would be sufficient to do that.

[fol. 75] It is not necessary to remind you that the Equitable is a mutual company. It is not a profit-making organization. Its purpose is to issue policies, which, in the aggregate, will—on which, in the aggregate, the Society will break even.

Now, in the opinion of the Equitable Society, if Mrs. Keller had lived her normal expectancy, then the $1200.00 collected initially, as we will say, and if they maintained those contracts in force until her death, would have been sufficient in the aggregate over the lifetime of Mrs. Keller.

It was estimated that the $1200.00 would be sufficient, but, if Mrs. Keller had died the day after the issuance of those contracts, the Equitable Society would have paid—may I have the letter which quotes?

(Whereupon document was handed to the witness)

"A. (Continuing:) I am quoting from this letter: 'Would have paid in commissions, expense allowance to general agent, and premium tax, a total of $1475.97':"

I am quoting that figure from the letter received from the Equitable. Their statement is more authoritative than mine. I assume the amounts entered in their letter are the amounts paid. To my belief all of those items are payable immediately. I know the agent's commission is payable immediately, the general agent's expense allowance; the only item I cannot answer is premium tax, which I assume is payable immediately, or within the fiscal year. I can answer definitely with respect to general agent's com-

mission and agent's allowance. When the premium tax was paid, I cannot answer that, since that was paid by the Equitable and not my agency.

"Q. One more question. You said that experience showed that the issuance of this policy was not profitable to the Equitable Assurance Society and therefore, they had to [fol. 76] change the rates and also require a physical examination. What do you base that statement on; what particular knowledge do you have in regard to that?

"A. I have, although I don't have it with me, a letter from our home office announcing that increase in rate—or, rather, the requirement of a ten per cent margin instead of six."

As to what rates the Equitable can charge on various policies, that is a matter for their own decision, with the approval of the insurance department If the insurance department had ordered that these rates be increased, the Equitable would not have refused to increase its rates, even though it didn't want to.

"Q. Will you state why the annuity contract is not cancellable so as to leave the life insurance contract in effect?

"A. Why, a life annuity may not be cancelled.

"Q. And still leave the other in effect?

"A. This annuity is a contract by which, in return for the consideration, in return for a consideration of $3258.20 the Equitable Society agrees to pay to a woman seventy-four and three-quarters years old, a semi-annual income of $195.42. All life annuities are issued on the basis of income for life, with no benefit at death. This contract has no cash value whatever. In other words, in the purchase of a life annuity, the individual exchanges principal for a guarantee of income. The expression which actuaries use, is that the principal is sunk, it is gone, and he has only income which he receives during his entire lifetime. He has no privilege of termination. He has simply purchased an income for life.

"Q. Isn't it a fact that that annuity contract has no cash value, so that all funds attributable to that annuity contract have been allocated to that life insurance contract?

[fol. 77] "A. No."

Redirect examination:

No life annuity contract has cash surrender value.

"Q. Now, I ask you to take this piece of paper and a pencil and calculate these figures with regard to showing whether the company could have a loss. What is the cash surrender value five years after the policy was enforced, according to the policy itself?

"A. The cash value is $859.00 for each one thousand of face value; twenty times that is $17,180.00.

"Q. Now, I ask you to put down on that paper what the amount was paid in the single premium?

"A. $17,941.80.

"Q. Now, will you subtract from that the cash surrender value at the end of five years?

"A. $761.80.

"Q. Now, then, during that five years, according to the letter from the insurance company which is in evidence, the insured got, during the year 1935, in dividends on the policy, she got the sum of $122.60 in 1935, that was the amount of dividends. Assuming that the dividends would average that amount, what dividends would she get basing the same dividends as 1935, for a period of five years?

"A. $613.00.

"Q. Now, subtract those amounts of dividends, and how much at the end of five years, taking the life insurance contract alone, how much left out of the single payment premium would the insurance company have of that premium at the end of five years if she took the cash surrender value, and figure the amount of dividends she got for five years, how much would the company have left?

"A. $148.80.

[fol. 78] "Q. Now, then, I ask you to take the amount of premium, the single premium that she paid for the annuity policy; that is how much?

"A. $3,258.20.

"Q. Now, will you add to that the $148.80 left of the insurance premium; what does that total?

"A. $3,407.00.

"Q. Now, then, according to the annuity contract, she was to be paid in two semi-annual payments, a total of $390.84 annually, wasn't she?

"A. That is right.

"Q. Now, divide that $390.84 annually by the amount of $3,407.00 which represents the amount of premium on the annuity policy, plus what the company had left on the dividend, and see what that per cent is?

"A. Eleven per cent plus.

"Q. Then, in other words, if this insured, five years after she took out the policy, or at the age of seventy-nine and a fraction, would take the cash surrender value of the insurance policy and then continue her annuity policy, the company from then on would have to pay her eleven per cent of the fund that they had, would they not?

"A. That is right.

"Q. Is that right, approximately?

"A. Eleven per cent.

"Q. Now, do you know what per cent the Equitable policy approximately counts on its return from the funds which it has to invest?

"A. The earnings have ranged between three and a half and four per cent during the past several years.

"Q. So that the company would earn on that principal which it had left, between three and a half and four per cent, and have to pay as long as the annuitant lived after the age of seventy-nine and a fraction, approximately eleven per cent; is that right?

[fol. 79] "A. That is true.

"Q. Would that mean a risk or a loss on the part of the Equitable Company?

"A. Yes."

Recross-examination:

"Q. What was the annual rate of earnings on the part of this insurance company for the year 1934?

"A. I don't know the exact amount. It was between three and a half and four per cent. I am quite certain; I cannot give you the exact amount."

Redirect examination:

It is quite common practice among life insurance salesmen to speak of life insurance policies as investments. In fact, there is a book called "Life Insurance as an Investment", written by Dr. Huebener and Dr. McCahan of the Wharton School of the University of Pennsylvania.

Thereupon, DR. C. L. PALMER, called as a witness on behalf of the petitioners (respondents on review), having been first duly sworn, testified as follows:

Direct examination:

I am a practicing physician, located at Diamond Bank Building, Pittsburgh. I have practiced medicine since 1905 in this community. I was called upon to visit Anna M. Keller, in a professional capacity. It was approximately March 23, 1936. At that time I got a case and life history of the patient. As is customary in consultation on a case with another physician, I always obtain a complete history, [fol. 80] that is, the family history, the party's history, past medical history, and history of the present illness, together with as complete a physical examination as can be made in the home under the circumstances. Her family history revealed nothing that would have anything to do with her state of health at that particular time or for a number of years previous. Her past medical history revealed nothing. By "revealed nothing" I mean it was a negative history. There were no diseases in her past medical history, or injuries or operations, or any conditions which might have to do with her present illness or with her state of health previous to her present illness. She had the usual childhood diseases and the ordinary births that the average woman has with complete recoveries in all of them. Her present history revealed the fact that she had been ill for some ten days previous to the time I saw her. At that time the diagnosis was grippe by her physician, Dr. Lamb, who is her son-in-law, and, under those conditions, being a member of the family, he was not alarmed about the condition of the patient, but felt that he would like to have a division of the responsibility at that time, which, of course, was granted him. The examination was practically negative. That is, there was nothing wrong at that particular time except the history she had that she had a respiratory infection or a grippe, and she was recovering. Her temperature was normal, here blood pressure was 150 over 100, and her heart and lungs and her abdominal organs were all practically normal, and it was only a question of division of responsibility on account of the relationship there, together with advice as to what course she should pursue in the immediate future. That was March 23, 1936. She was recovering

from her grippe condition at that time and her general condition was practically normal. As to her general condition, I observed that she must have been an individual who had been fortunate in having excellent health for a great many years. In fact, her history indicated that, and to my knowl- [fol. 81] edge of her personally from being connected with the family, and seeing other members of the family sick at various times, and seeing her, would indicate that she was an individual of excellent health. I don't remember having seen her in the winter of 1934 other than in a professional capacity, but I saw her a number of times; I was in and out of her house on account of illness of her daughter. I had seen her a number of times previous to 1936, probably for ten or fifteen years previous to that. I would say her physical condition, general appearance, and all, indicated that she was normal.

Cross-examination:

The first time I made a physical examination of the decedent was on March 23, 1936. I made the usual type of physical examination that is made in a consultation, complete history and examination of all the organs, physical examination through palpation and so forth. I have no records with me to show the report that I made at that time. I did not make a written report at that time. I am testifying from memory. I would say that it took me about an hour to make this examination.

Thereupon, Dr. W. J. Lamb, called as a witness on behalf of the petitioners (respondents on review), having been first duly sworn, testified as follows:

Direct examination:

I am a practicing physician in this community. I have practiced in this community for thirty-three years. I am the son-in-law of the decedent, Anna M. Keller. Because of that relationship, I frequently saw the decedent. I lived along side of her from twelve to fifteen years—in the adjoining house, next door to her. I mean from twelve to fif- [fol. 82] teen years prior to her death. She was always a very healthy, active woman prior to December 30, 1934. I never heard of her having any sickness up until ten days or

two weeks prior to her death, in March, 1936. Her condition as to her general vitality and physical health was very good, very active; she enjoyed life. She went on tours; she went to ball games. In fact, two days before she died, she mentioned getting seats for the opening ball game with me. If she had any expectancy of dying within a short time, I never heard her express it, if she did. I never heard her mention death at all. In fact, if I recall, she figured on taking a trip abroad the summer after her death—I heard her express an opinion that she wanted to go abroad in the summer, that is, of 1936. As near as I can recall, she took trips abroad three or four times, trips to California—I wouldn't be positive if she took her last trip abroad in the summer of 1934 or 1933; as I recall, it was about three years before she died. At the time I called in Dr. Palmer she was convalescent from an attack of the grippe and I called—my wife or my sister-in-law, I cannot recall which one, suggested that as long as she was in bed, it might be a good idea to have Dr. Palmer come out and examine her in regard to her condition and her general health. I called Dr. Palmer and he said to me, "What is the use of me coming out; she is all right." After he had seen her. I told him why I called him out, and so he examined her and he said she was in very good shape, very good health. Mrs. Keller died of a cerebral hemorrhage, apoplexy, a stroke. That is what is commonly called a stroke. I had taken her blood pressure at frequent intervals, oh, for four or five years before her death and it was always normal or subnormal, never high.

[fol. 83] Cross-examination:

I have no written records in my possession relating to the physical condition of the decedent. I am just testifying from memory.

Redirect examination:

I am the doctor who made out the death certificate that she died of cerebral hemorrhage.

Thereupon, MARCELLA V. KELLER, a witness called on behalf of the petitioners (respondents on review), having been first duly sworn, testified as follows:

I am the daughter of Anna A. Keller, the decedent. I was living with my mother at the time of her death. I had lived with my mother all of my life. I was living with her during the winter of 1934. I lived with her continuously except maybe for brief trips. Mother always enjoyed good health with the exception of an occasional sore throat or a little grippe; she was always very healthy. She enjoyed life to the fullest; she was even looking forward to a trip to Europe. That was the summer of 1936. She looking forward to going to Europe the year she died. Her last trip to Europe was in 1931. Mother enjoyed riding very much. She liked to tour and take trips. Very often she was scarcely home, she wanted to get started and go again. She enjoyed baseball very much and music and motion pictures and just the regular line of enjoyment everybody would enjoy.

"Q. State whether or not your mother, during the winter and fall of 1934, was enjoying life, or whether she was morose or whether she had any idea that she might die soon or expected to live for some time, or just what was your [fol. 84] mother's attitude towards life?

"A. Well, mother never spoke of death and I don't think she ever contemplated an early death, because her mother and grandmother were very old when they died; they were in the nineties; and she was always looking forward to enjoying life and having a good time. She had a very happy disposition."

The foregoing evidence is all of the material evidence adduced at the hearing before the Board of Tax Appeals, and the same is approved by the undersigned, J. P. Wenchel, Chief Counsel, Bureau of Internal Revenue, as attorney for the Commissioner of Internal Revenue.

(Signed) J. P. Wenchell, R. L. W., Chief Counsel, Bureau of Internal Revenue.

The foregoing is all of the material evidence adduced at the hearing before the Board of Tax Appeals, and the same is approved by the undersigned, as attorney for the respondents on review.

(Sgd.) F. T. Weil, Attorney for the Respondents on Review.

ORDER SETTLING STATEMENT OF EVIDENCE

The foregoing is all of the material evidence adduced at the hearing and in order that the same may be preserved and made a part of the record, this statement of evidence is duly approved and settled this 27th day of November, 1939.

(s) Eugene Black, Member, U. S. Board of Tax Appeals.

RFS-spt. 10-3-39.

[fol. 85] BEFORE UNITED STATES BOARD OF TAX APPEALS

STIPULATION OF FACTS—Filed November 8, 1938

It is hereby agreed between the parties hereto by their attorneys that the following facts shall be taken as true, provided, however, that this stipulation shall be without prejudice to the right of either party to introduce other and further evidence not inconsistent with the facts herein stipulated to be taken as true.

1. The petitioners, Pius P. Keller and Marcella V. Keller as Executors of the Estate of Anna M. Keller, deceased, filed on November 6, 1936, on their behalf an estate tax return with the Collector of Internal Revenue for the 23rd District of Pennsylvania, a photostatic copy of which is attached hereto, made part hereof, and marked Exhibit "A".

2. The only matter before the Board and at issue is the disallowance of petitioners' claim in the amount of $20,030.43 as proceeds paid on an insurance policy No. 9,652,636, issued by the Equitable Life Assurance Society of the United States, as a portion of the $40,000 exemption provided for in Section 302 (g) of the Revenue Act of 1926, as amended, and whether the purchase of the two policies amounted in substance to a transfer by trust or otherwise under which the decedent retained for life the enjoyment of or the right to the income from the property within the meaning of Section 302 (c) of the Revenue Act of 1926, as amended, and the resulting deficiency in Federal estate taxes of the petitioners as determined by the Commissioner of Internal Revenue.

3. The Commissioner of Internal Revenue mailed a notice of deficiency in Federal estate taxes to the petitioners [fol. 86] as executors of the Estate of Anna M. Keller on January 29, 1938, a copy of which is attached hereto, made a part hereof, and marked Exhibit "B".

4. The decedent, Anna M. Keller, at the age of 74 and ¾ years, effective at the age of 75, executed on December 31, 1934, a policy or contract with Equitable Life Assurance Society of the United States, designated on its face "Life Annuity—Single Premium—Non-Participating." This policy or contract is numbered 9,652,635 and provides for the payment of a single premium of $3,258.24 to the Insurance Company with semi-annual annuity income payments to the annuitant of $195.42. A copy of said policy or contract and application is attached hereto, made part hereof, and marked Exhibit "C".

5. On the same date, to-wit, December 31, 1934, the decedent executed a policy or contract designated on its face "Single Premium Life Policy" for the face amount of $20,000. This policy or contract is numbered 9,652,636 and provides for the payment of a single premium of $17,941.80. A photostatic copy of said policy or contract and application is attached hereto, made part hereof, and marked Exhibit "D".

6. A physical examination of the insured was not required by the Equitable Life Assurance Society of the United States in connection with the execution or issuance of policy or contract number 9,652,636.

7. The decedent, Anna M. Keller, died on March 28, 1936, a resident of Pittsburgh, Pennsylvania. A true and correct copy of the Certificate of Death is attached hereto, made part hereof, and marked Exhibit "E".

8. Based upon the Mortality Table forming the basis for the annuity rate under contract No. 9,652,635, the expectation of life of a female of the age of 74 and ¾ years is 10.5 years.

[fol. 87] 9. On a basis of the Mortality Table used to compute the premium under contract No. 9,652,636, designated thereon as "Single Premium Life Policy," the expectation of life of a female at the age of 75 is 6.3 years.

10. The decedent during her lifetime received on policy No. 9,652,635 two semi-annual income payments in the year 1935 each in the amount of $195.42, making a total of $390.84, and also received in 1935 a dividend disbursement in connection with policy No. 9,652,636 amounting to $122.60. There was also paid by said Equitable Life Assurance Society of the United States $20,000 face amount of policy No. 9,652,636 to Marcella V. Keller, the beneficiary named in said policy plus a Post Mortem Dividend of $30.43 paid in Death Claim Settlement.

11. There are attached hereto, made a part hereof and marked Exhibits "F" and "G" respectively, true and correct copies of a letter dated December 21, 1937, addressed to the Equitable Life Assurance Society of the United States and signed by Deputy Commissioner, D. S. Bliss, and the Equitable Life Assurance Society's reply addressed to said Deputy Commissioner Bliss and dated January 6, 1938.

12. There are attached hereto, made a part hereof, and marked Exhibits "H" and "I", true and correct copies of a letter dated November 1, 1938, addressed to the Equitable Life Assurance Society of the United States and signed by Weil, Christy & Weil, and the Equitable Life Assurance Society's reply, dated November 3, 1938, addressed to Weil, Christy & Weil and signed by L. D. Fitzgerald, Assistant Superintendent, said Exhibits being admitted as evidence in this case with the understanding, however, that the designation of the term life insurance in said Exhibits as applying to policy No. 9,652,636 is not to be construed as an admission by the Respondent that said policy is a life insurance contract, and that said designa-
[fol. 88] tion of said contract as a life insurance policy is in no way to prejudice the Respondent's rights in the premises.

F. T. Weil, Attorney for Petitioners, (S.) J. P. Wenchel, Chief Counsel, Bureau of Internal Revenue.

[fol. 89] In United States Circuit Court of Appeals

Order re Exhibits—Filed October 23, 1939

Upon consideration of the Motion filed hereby by counsel for petitioner on review, and assented to by counsel for

respondent on review, moving the Court to permit the transmission to this Court of five copies each of Exhibits "C" and "D", attached to the stipulation of facts filed with the United States Board of Tax Appeals, as physical exhibits, not to be included in the printed record on review, it is by the Court this 20th day of October, 1939

Ordered, that the said Motion be and is hereby granted.

And it is further ordered that the Clerk of this court transmit a certified copy of this order to the Clerk of the United States Board of Tax Appeals, to be by him incorporated in the record on review.

By the Court.

(S.) Albert B. Maris, Circuit Judge.

RFS opt 10-12-39.

Received & Filed Oct. 20, 1939. Wm. P. Rowland, Clerk.

[fol. 90] BEFORE UNITED STATES BOARD OF TAX APPEALS

PRAECIPE FOR RECORD—Filed November 27, 1939

To the Clerk of the United States Board of Tax Appeals:

You will please prepare, transmit and deliver to the Clerk of the United States Circuit Court of Appeals for the Third Circuit, copies duly certified as correct of the following documents and records in the above-entitled cause in connection with the petition for review by the said Circuit Court of Appeals for the Third Circuit, heretofore filed by the Commissioner of Internal Revenue:

1. Docket entries of the proceedings before the Board.
2. Pleadings before the Board.

(a) Petition, including annexed copy of deficiency notice, but excluding Exhibits "B" and "C";

(b) Answer.

3. Findings of fact, opinion and decision of the Board.
4. Petition for review, together with proof of service of notice of filing petition for review and of service of a copy of petition for review.
5. Statement of evidence as settled and allowed, including the stipulation of facts filed at the hearing, but excluding therefrom Exhibits "A" to "I", inclusive.

Order of Court Re Transmission of exhibits.

6. Order enlarging time for the preparation of the evidence and for the transmission and delivery of the record.

[fol. 91] 7. This praecipe.

(Signed) J. P. Wenchel, R. L. W., Chief Counsel, Bureau of Internal Revenue.

Service of a copy of the within praecipe is hereby admitted this 22 day of November, 1939.

(Sgd.) F. T. Weil, Attorney for Respondents on Review.

[fol. 92] CERTIFICATE

I, B. D. Gamble, Clerk of the U. S. Board of Tax Appeals, do hereby certify that the foregoing pages, 1 to 78, inclusive, contain and are a true copy of the transcript of record, papers, and proceedings on file and of record in my office as called for by the Praecipe in the appeal (or appeals) as above numbered and entitled.

In testimony whereof, I hereunto set my hand and affix the seal of the United States Board of Tax Appeals, at Washington, in the District of Columbia, this 4th day of Dec. 1939.

B. D. Gamble, Clerk, United States Board of Tax Appeals. (Seal.)

[fol. 93] IN THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT, OCTOBER TERM, 1939

No. 7242

COMMISSIONER OF INTERNAL REVENUE, Petitioner

vs.

ESTATE OF ANNA M. KELLER, PIUS P. KELLER and MARCELLA V. KELLER, Executors, Respondents

And afterwards, to wit, the 20th day of February, 1940, come the parties aforesaid by their counsel aforesaid, and this case being called for argument sur-pleadings and briefs, before the Honorable John Biggs, Jr., Honorable William Clark and Honorable Charles Alvin Jones, Circuit Judges, and the Court not being fully advised in the premises, takes further time for the consideration thereof,

And afterwards, to wit, on the 28th day of May, 1940, come the parties aforesaid by their counsel aforesaid, and the Court, now being fully advised in the premises, renders the following decision:

[fol. 94] IN THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT, OCTOBER TERM, 1939

No. 7242

COMMISSIONER OF INTERNAL REVENUE, Petitioner,

v.

ESTATE OF ANNA M. KELLER, PIUS P. KELLER and MARCELLA V. KELLER, Executors, Respondents

Petition for Review from the United States Board of Tax Appeals

OPINION—Filed May 28, 1940

Before Biggs, Clark and Jones, Circuit Judges

CLARK, Circuit Judge:

No one knows better than insurance salesmen that only the "excess over $40,000" of life insurance proceeds re-

ceivable by beneficiaries other than the insured's executor are subject to the estate tax, 26 U. S. C. A. § 411(g). This $40,000 exemption, a unique characteristic of their general stock in trade, is quite naturally stressed to the customer. Sometimes, however, it is stressed to a paradoxical extreme. The paradox consists in applying a life insurance exemption to the estate of an uninsurable prospect.[1]

[fol. 95] Mrs. Keller, the prospect (or rather decedent) at bar, had at the age of seventy-five no choice but to follow the course prescribed for uninsurables. She took out a single premium life policy in conjunction with a single premium annuity. Her estate now seeks to complete that course by securing the benefit of the $40,000 exemption. Opinions are divided as to whether it may do so. A majority of the Board of Tax Appeals and a unanimous Second Circuit Court of Appeals accept the paradox and allow the exemption.[2] On the other hand, a unanimous Eighth Circuit Court of Appeals and several students of the question have taken the opposite view.[3] We are constrained to do likewise:

---

[1] Salesmen are instructed:

"If the prospect has a reasonable income *and is insurable* he unquestionably should be advised to purchase annual premium life insurance to take advantage of his full insurance exemption. *If he is not insurable* a single premium life or endowment policy combined with an annuity provides the prospect with income comparable with that received from high grade bonds, and at the same time secures him this additional tax saving."

Wright & Lowe, Selling Life Insurance Through A Tax Approach, pp. 80, 81.

[2] Estate of Anna M. Keller, 39 BTA 1134; Commissioner v. Le Gierse, —— F. (2d) —— (decided March 24, 1940); Fisher v. Commissioner, BTA, June 22, 1939 (unreported memorandum opinion now on appeal to the 7th Circuit Court of Appeals); see also Bowman v. Tax Com., 135 Ohio St. 395; Matter of Ruppel, New York Law Journal, March 12, 1937; Clark, Inheritance and Estate Taxes on Life Insurance, pp. 184, 199-200.

[3] Helvering v. Tyler, —— F. (2d) —— (decided April 29, 1940); Greenfield, Federal Taxation of Combined Annuity and Life Insurance Contracts, 49 Yale Law Journal 946

One may ask at the outset: how does an uninsurable life become insured? The explanation lies in the mathematical [fol. 96] correspondence between annual interest and annuity payments. $100 due in ten years at 2% is precisely the same thing as an annuity certain of $2 for ten years combined with a promise to pay $100 without interest at the end of ten years. The discounted sums required to meet the annuity payments plus the discounted sum required to pay the $100 when due will always total $100, the amount of the loan.[4] The same holds true if the loan is repayable at the death of the lender. The obligation of the borrower may be divided into a complete annuity of $2 combined with a whole life insurance of $100. One merely substitutes for the ten year term a series of probabilities of being alive (annuity) and of being dead (life insurance) in the future. The relation between these converse probabilities is such that the discounted sum required to provide the annuity plus that required to produce the life insurance will always be equal to the amount of the loan. We say always because the relation between the probabilities of living and dying is from the very nature of the mortality tables, on which they are calculated, constant, no matter what the age of the lender. So, an insurance company may borrow $100 at 2% from one doomed to die within ten minutes and issue in return a $2 annuity and a $100 life policy. By an actuarial tour de force (because the continuane of life is a matter of minutes, not probabilities) the amount of the loan advanced is split into the single premiums appropriate to each policy if taken out by a normal person. In other words, the sure thing (loan) is artificially separated into doubtful bet (life insurance) and hedge (annuity). It is on this general principle that an uninsurable life becomes "insured". See Appendix to this opinion.

The transaction between Mrs. Keller and the insurance company was cast in the same mould. There are, to be

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(note); Life Insurance and the Federal Estate Tax, 40 Columbia Law Review 86 (note); 52 Harvard Law Review 1181 (note); 38 Michigan Law Review 526 (note); 32 Illinois Law Review 223, 232 (note); see also, State ex rel. Thornton v. Probate Court, 186 Minn. 351; Old Colony Trust Co. v. Commissioner, 102 F. (2d) 380, and cases there cited.

[4] See, Wolfe, Inheritance Tax Calculations, pp. 15, 16.

sure arithmetical ramifications. Life and annuity premiums were computed on different mortality tables at dif-
[fol. 97] ferent rates of interest, and included "loading charges" to meet premium taxes and agents' commissions. These, however, present no essential point of dissimilarity. The two premiums, exclusive of loading charges, add up to $20,000, the face amount of the life policy. Apart from the effects of a slight miscalculation in loading charges, Mrs. Keller's death, no matter when it occurred, could never require the company to look to funds contributed by other policy holders in order to make the life insurance payment. That being so, we can detect no substantial economic distinction between the conjoint effect of the two policies issued, and that of an engagement to repay Mrs. Keller, or her order, $20,000 upon her death, with interest at almost exactly 2% per annum ($390.84 being payable under the annuity) in the meantime. It is plain, furthermore, that the economic consequences of a loan were intended. Mrs. Keller did not undergo a physical examination, and it is conceded that the company would not have issued the life policy without the annuity.

Nevertheless, Mrs. Keller died the holder of a paid up, standard form, life insurance policy, with a cash surrender value, a right to change the beneficiary, and all the usual paraphernalia of such contracts. Its proceeds were payable to her daughter. The initial legal problem, therefore, is whether those proceeds constitute an "amount receivable by * * * beneficiaries *as insurance* under policies taken out by the decedent upon his own life" within the meaning of the taxing statute.

We think the question turns upon whether the adverbial phrase, "as insurance" refers to the legal, or to the economic, method whereby the amount is received. The legal mechanism employed at bar is unquestionably a contract of life insurance. An action could be brought on that policy to recover its proceeds, without the annuity being in any wise involved. The annuity, on the other hand, is not only a cog but also an indispensible cog in the economic machine which produced the amount received by the beneficiary. That machine, therefore, fulfilled none of the com-
[fol. 98] posite functions of life insurance. Being in its essence a loan transaction it neither "built up an estate", nor caused the company to assume, on loose principles of indemnity, any risk of loss occasioned by premature death, Vance, Handbook of the Law of Insurance, pp. 80, 123 et

seq.; Cooley, Briefs on the Law of Insurance p. 80. What is more important, such a risk, being non-existent, could not be so assumed pursuant to a plan of spreading it among a large section of the population, i. e., other policy holders, See An Analysis of "Insurance" and "Insurance Corporation", 36 Columbia Law Review 456 (note). Mrs. Keller merely paid $20,000 to obtain $20,000 at her death. We may observe parenthetically that promissory notes payable at the death of the obligor have long been countenanced in the law, 1 Daniel on Negotiable Instruments p. 45; 2 A. L. R. 1471 (note). The makers of such engagements (to say nothing of the learned framers of the Uniform Negotiable Instruments Law § 4(3)) might be more than mildly shocked to find that they had defied the local Insurance Commissioner and written a policy of life insurance on their own lives.

It is plain in our estimation that the Congress used the word "insurance" with the economic rather than the purely contractual aspects of the term in mind. The statute prescribes an exemption prompted by a settled policy favoring the institution of life insurance.[5] The economic workings of that institution produce, upon premature death, the sudden "springing up"[6] of a fund which rescues the insured's beneficiaries, who are ordinarily within the family circle, from want. This result is both salutary and unique. The [fol. 99] fund insofar as it springs up comprises not only the accumulated interest on premiums paid (as is more or less the case with non-exempt savings bank accounts) but also a multitude of painlessly infinitesimal contributions from others who have escaped premature death. Life insurance is, therefore, the least costly and most equitable device yet evolved to preserve families in a wage-earning society from destitution. Obviously the exemption is meant to encourage life insurance as such a device. The language of encouragement, then, must be taken to refer to the economic functions, not the bare legal attributes of insurance.

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[5] Hughes, The Federal Death Tax pp. 88-91. For criticisms as to the actual working out of this policy see, Paul, Life Insurance and the Federal Estate Tax, 52 Harvard Law Review 1037, 1076. The British death duty affords no exemption, 13 Halsbury's Laws of England pp. 241, 242.

[6] Attorney General v. Robinson, 2 I. R. 67, 90.

We hold, accordingly, that the amounts receivable under Mrs. Keller's life policy were not receivable as insurance. They may, moreover, be properly included in her gross estate, Old Colony Trust Co. v. Commissioner, above cited. The Commissioner suggests that the transfer section of the statute is applicable, but cites no authority. The respondent executors make no argument on the point whatever. In view of this apparent concession the appropriateness of any particular section becomes of artistic importance only and does not merit discussion, see 38 Michigan Law Review 526 (note), above cited; and cf. Paul, Life Insurance and the Federal Estate Tax, 52 Harvard Law Review 1037, above cited; Oppenheimer, Proceeds of Life Insurance Policies Under the Federal Estate Tax, 43 Harvard Law Review 724; 82 University of Pennsylvania Law Review 384 (note).

The decision of the Board of Tax Appeals is reversed.

A true Copy. Teste:

——— ———, Clerk of the United States Circuit Court of Appeals for the Third Circuit.

[fol. 100] APPENDIX

The actuarial symbol for the single premium on a life insurance of $1 due at the end of the year of death of a person now aged x years is A_x. The symbol for the single premium on an annuity of $1 payable at the end of each year the annuitant survives is a_x. Both are calculated with appropriate discount in accordance with the probabilities of continued life (annuity) or of discontinued life (insurance) as shown by mortality tables. The relation between them may be expressed as

$$a_x = \frac{1 - A_x(1+i)}{i} \text{ or } A_x(1+i) + i\,a_x = 1,$$

i being the interest rate. See King, Life Contingencies, Institute of Actuaries Textbook, Vol. 2, p. 125. That being so, a single premium on a *whole* life insurance of $1 (payable at the instant of death) combined with a single premium on a *complete* annuity (apportioned in the year of death) of the interest (i) on $1 will always equal $1. For, expressing the combination of the whole life insurance ($\bar{A}_x$) and the complete annuity ($\bar{a}_x$) algebraically, we have:

$$
\begin{aligned}
A_x + i\,a_x &= A_x\,(1+i)^{\frac{1}{2}} + i\,[a_x + \tfrac{1}{2}\,A_x\,(1+i)^{\frac{1}{2}}] \\
&= A_x\,(1+i)^{\frac{1}{2}} + i\left[\frac{1 - A_x\,(1+i)}{i} + \tfrac{1}{2}\,A_x\,(1+i)^{\frac{1}{2}}\right] \\
&= A_x\,(1+i)^{\frac{1}{2}} + 1 - A_x\,(1+i) + i/2\,A_x\,(1+i)^{\frac{1}{2}} \\
&= 1 + A_x\,[\,(1+i)^{\frac{1}{2}}\,(1+i/2) - (1+i)] \\
&= 1 + A_x\,[(1+i)^{\frac{1}{2}}\,(1+i)^{\frac{1}{2}} - (1+i)] \\
&\qquad \text{Since } (1+i/2) = (1+i)^{\frac{1}{2}} \text{ approx.} \\
&= 1 + A_x\,[(1+i) - (1+i)] \\
&= 1 + A_x\,(0) \\
&= 1
\end{aligned}
$$

[fol. 101] This, of course, is merely a roundabout way of stating that the sum required to repay a loan of $1 at i per cent interest is $1 where the prevailing rate of interest is i. The mortality factors, a_x and A_x cancel out no matter what age is used. See generally, Wolfe, Inheritance Tax Calculations, pp. 40, 85.

The equation $\bar{A}_x + i\,\mathring{a}_x = 1$ is frequently exploited in the statutory valuation of remainders after life estates. The life estate valued as an annuity (or more accurately, as a complete annuity) is deducted from the whole estate and the difference taken as the value of the remainder, Wolfe, above cited, pp. 4, 5.

[fol. 102] In the United States Circuit Court of Appeals for the Third Circuit, October Term, 1939

No. 7242

Commissioner of Internal Revenue, Petitioner,

vs.

Estate of Anna M. Keller, et al., Respondents

Appeal from the United States Board of Tax Appeals.

This cause came on to be heard on the transcript of record from the United States Board of Tax Appeals, and was argued by counsel.

On consideration whereof, it is now here ordered, adjudged, and decreed by this Court that the order or decree of the said Board of Tax Appeals in this cause be, and the same is hereby reversed.

Philadelphia, May 28, 1940.

William Clark, Circuit Judge.

Endorsements—Order Reversing Decree. Received & Filed May 28, 1940. Wm. P. Rowland, Clerk.

[fol. 103] UNITED STATES OF AMERICA,
Eastern District of Pennsylvania,
Third Judicial Circuit, set:

I, Wm. P. Rowland, Clerk of the United States Circuit Court of Appeals for the Third Circuit, do hereby certify the foregoing to be a true and faithful copy of the original Transcript of Record and proceedings in this court in the case of Commissioner of Internal Revenue, Petitioner, vs. Estate of Anna M. Keller, et al., Executors, Respondents, No. 7242, on file, and now remaining among the records of the said Court, in my office.

In Testimony Whereof, I have hereunto subscribed my name and affixed the seal of the said Court, at Philadelphia this 12th day of August in the year of our Lord one thousand nine hundred and forty and of the, Independence of the United States the one hundred and sixty-fifth.

Wm. P. Rowland, Clerk of the U. S. Circuit Court of Appeals, Third Circuit. (Seal.)

[fol. 104] SUPREME COURT OF THE UNITED STATES

ORDER ALLOWING CERTIORARI—Filed October 14, 1940

The petition herein for a writ of certiorari to the United States Circuit Court of Appeals for the Third Circuit is granted, and the case is assigned for argument immediately following No. 368.

And it is further ordered that the duly certified copy of the transcript of the proceedings below which accompanied the petition shall be treated as though filed in response to such writ.

Endorsed on cover: File No. 44,720. U. S. Circuit Court of Appeals, Tnird Circuit. Term No. 371. Estate of Anna M. Keller, Pius P. Keller and Marcella V. Keller, Executors, Petitioners, vs. Commissioner of Internal Revenue. Petition for a writ of certiorari and exhibit thereto. Filed August 23, 1940. Term No. 371, O. T., 1940.

FILE COPY

Office - Supreme Court, U. S.
FILED
AUG 23 1940
CHARLES ELMORE CROPLEY
CLERK

IN THE

Supreme Court of the United States

..... TERM, 1940.

NO. 371

ESTATE OF ANNA M. KELLER, PIUS P. KELLER and MARCELLA V. KELLER, Executors,
Petitioners,

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT.

FERDINAND T. WEIL,

J. SMITH CHRISTY,

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IN THE

Supreme Court of the United States

..... TERM, 1940.

NO. .....

ESTATE OF ANNA M. KELLER, PIUS P. KELLER and MARCELLA V. KELLER, Executors,
Petitioners,

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT.

To the Honorable Chief Justice and Associate Justices of the Supreme Court of the United States:

The petition of Estate of Anna M. Keller, Pius P. Keller and Marcella V. Keller, Executors, represents:

Summary and Statement of the Matter Involved.

This proceeding was initiated when petitioners filed a petition with the United States Board of Tax Appeals for a redetermination of a deficiency which the Commissioner of Internal Revenue had determined to be due from petitioners as additional estate tax.

The question presented by the record is one of exemption from estate taxation, viz: Upon the death

of a decedent who in her lifetime executed on the same day but as separate contracts a single premium life insurance contract and a single premium annuity contract, is the amount (being less than $40,000) received by the life insurance beneficiary "insurance" as that term is used in Section 302 (g) of the Revenue Act as amended, and accordingly exempt from estate taxation and not includible in decedent's gross estate?

The Board of Tax Appeals reversed the Commissioner and held that there was no deficiency in estate tax. The Board's Findings of Fact will be found in the Record, pp. 13-24 and the Opinion, pp. 24-46.

The United States Circuit Court of Appeals for the Third Circuit reversed the Board of Tax Appeals. The Circuit Court's opinion will be found in the Record, pp. 94-101.

The facts as found by the Board of Tax Appeals are substantially as follows (R. 14-24):

Petitioners are the executors of the estate of Anna M. Keller, deceased. The decedent died March 28, 1936. (R. 14.)

On December 31, 1934, the decedent, at the age of 75, executed a contract with the Equitable Life Assurance Society of the United States, sometimes hereinafter referred to as the insurance company. The contract is designated "Life Annuity. Single Premium. Non-Participating" and provides for the payment of a single premium of $3,258.20 to the insurance company in consideration for semi-annual annuity income payments of $195.42 by the insurance company to the annuitant during her lifetime. The contract was on the regular standard form used by the insurance company for writing annuity contracts, and among other things provided

that "this agreement, and the application therefor, a copy of which is endorsed hereon or attached hereto, constitute the entire contract between the parties." (R. 14-15.)

On the same day that the annuity contract was executed, the decedent also executed a policy or contract with the insurance company for the face amount of $20,000 which was designated as "Single Premium Life Policy. Insurance Payable at Death. Single Premium. Annual Dividends." The policy was on the regular standard form used by the insurance company for writing life insurance policies. This insurance was granted in consideration of the payment in advance to the Society of a single premium of Seventeen thousand nine hundred forty-one and 80/100 Dollars. (R. 15-16.)

This policy also contained provisions relating to assignments, change of beneficiary, policy years, age and self-destruction. There was a provision captioned "The Contract" which provided as follows (R. 16-17): "This policy, and the application therefor, a copy of which is endorsed hereon or securely attached hereto, constitute the entire contract between the parties. * * *." The policy also contained a "Table of Loan and Cash Surrender Values for each $1,000 of Face Amount."

The company accepted in lieu of a medical examination the issuance of the life annuity contract, through which the company reduced but did not entirely eliminate its risk against loss due to premature death. (R. 18.) The insurance company would not have issued the insurance policy to the insured at her attained age of 75 years without issuing a life annuity contract in conjunction with the insurance policy but in computing the single premium paid for the life insurance contract, no adjustment was made for the amount received as a premium for the annuity contract. The considera-

tion charged for the annuity contract would have been the same even if no life insurance had been purchased at the time and the decedent could have obtained the annuity contract without the insurance policy, in which case the annuity would have been identically the same as in the annuity contract which was issued to the decedent. The requirement of the annuity contract as a condition precedent to the issuance of the insurance policy was due to the amount of risk involved, namely, the difference between the consideration and the death benefit. (R. 18-19.)

The total consideration paid by the decedent to the insurance company for the two contracts amounted to 106 percent of the face amount of the insurance policy or $21,000, which was $1,200 in excess of the face amount of the insurance policy. The name given to the $1,200 by the insurance company is "loading" and is for the purpose of paying commissions to the general agent and the special agent and for premium taxes. The actual expense exclusive of any profit and general overhead expense of the insurance company in issuing the two contracts in question was $1,475.97.

The above total charge of 106 percent on this type of contracts was later found to be unprofitable, at which time the charge was increased by the insurance company to 110 percent, and still later the issuance of an insurance policy like the one in question was made conditional upon a medical examination. (R. 19-20.)

The insurance company at all times treated the two contracts entered into with the decedent on December 31, 1934, as two separate transactions rather than as one transaction. (R. 20.) The company in its reports to the State Commissioner of Insurance listed the contracts separately—one under the life insurance group and the other under the annuity group.

The principal cause of decedent's death was cerebral hemorrhage of one-half day duration. Up until the time of her last illness the decedent had enjoyed excellent health, had been remarkably free from any illnesses or disabilities, had been especially active for one of her years, enjoyed life and never expressed any expectancy of dying, nor mentioned death. Her mother and her grandmother were both in their nineties when they died. (R. 24.)

The Commissioner included the proceeds of the life insurance in decedent's gross estate, claiming the entire transaction represented a transfer made to take effect at or after death, in accordance with the provisions of Section 803, Revenue Act of 1932, which amended Section 302 (c), Revenue Act of 1926, and imposed a deficiency in estate tax of $3,243.64. (R. 8-10.) The Board of Tax Appeals reversed this determination, holding that the proceeds of the life insurance is not includable in the decedent's gross estate as a transfer made in contemplation of death, or otherwise, and that the amount so paid represents "insurance under policies taken out by the decedent upon her own life" as that term is used in Section 302 (g) of the Revenue Act of 1926, as amended. The Circuit Court of Appeals reversed the decision of the Board of Tax Appeals.

Jurisdiction.

The judgment of the Circuit Court of Appeals was entered on May 28, 1940. No petition for rehearing was filed. The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code as amended by the Act of February 13, 1925 [28 USCA §347 (a)].

Question Presented.

Whether the amount paid by an insurance company to the beneficiary named in a life insurance policy taken out by the decedent on her own life (which was the standard form customarily used by the company) and which amount would unquestionably be considered "insurance" as that term is used in Section 302 (g) of the Revenue Act of 1926 as amended and therefore be excludible from decedent's gross estate, is not to be considered "insurance" and therefore is not excludible from the estate merely because the decedent, aged 75 when she took out said life insurance policy, also at the same time took out a separate annuity policy with the same company (which annuity policy was the standard form customarily used by the company) and without which annuity policy the company would not have issued said life insurance policy.

Statutes and Regulations Involved.

The pertinent statutes and regulations will be found in the Appendix, *infra,* pp. 9-10.

Reasons Relied on for Allowance of the Writ.

I. The decision of the Court below is in conflict with the decision of the Circuit Court of Appeals for the Second Circuit in *Commissioner v. LeGierse,* 110 F. (2d) 734, decided March 24, 1940, upon practically the identical facts as the case at bar and in which case the Court upheld as insurance and within the exemption of Section 302 (g) of the Revenue Act, a single premium life insurance policy issued on the standard form taken out by decedent, aged 80, although on the same date decedent purchased from the same company a single premium an-

nuity without which latter contract the company would admittedly not have issued the insurance policy.

II. In the case of *Commissioner v. LeGierse (supra)* the Commissioner has petitioned your Honorable Court at No. 237 October Term, 1940, for a Writ of Certiorari. That case which is in conflict with the case at bar and which is on similar facts and involves the same legal question as the case at bar, affirms the opinion of the Board of Tax Appeals, whereas the Circuit Court of Appeals in the case at bar reverses the opinion of the Board of Tax Appeals.

III. The decisions of the Circuit Court of Appeals of the Third Circuit in this case, of the Second Circuit in *Commissioner v. LeGierse (supra)* and of the Eighth Circuit in the case of *Commissioner v. Tyler,* 111 F. (2d) 422, decided April 29, 1940, all being decisions based on substantially the same facts, involve an identical and important question of federal law, upon which this Court is the ultimate arbiter, to-wit, Section 302 (g) of the Revenue Act of 1926, as amended, and which question has not been, but should be, settled by this Court.

IV. Your petitioners are advised, believe and therefore aver (and the Commissioner so states in his petition for Writ of Certiorari in *Commissioner v. LeGierse (supra)*) that the question here raised presents an important question in the administration of the federal estate tax laws and there are between 300 and 400 like cases pending in the Bureau of Internal Revenue involving substantial amounts of revenue. In other instances where the same question has been raised, the Treasury Department through the Bureau of Internal Revenue has held the matter in abeyance awaiting the ultimate decision in the instant case. The question is thus of sufficient importance to warrant final determination by this Court.

Conclusion.

In view of the conflict in decisons of various Circuit Courts of Appeal, the general importance of the question presented, and the petition for certiorari filed by the Commissioner in *Commissioner v. LeGierse (supra)* which conflicts with the Circuit Court's decision in the case at bar, it is respectfully submitted that the petition for certiorari be granted.

And your petitioners will ever pray, etc.

FERDINAND T. WEIL,

J. SMITH CHRISTY,

Attorneys for Estate of Anna M. Keller, Pius P. Keller and Marcella V. Keller, Executors, Petitioners.

APPENDIX.

Revenue Act of 1926, c. 27, 44 Stat. 9, as amended by Section 803 (a) of the Revenue Act of 1932, c. 209, 47 Stat. 169, and by Sections 401 and 404 of the Revenue Act of 1934, c. 277, 48 Stat. 680:

SEC. 302. The value of the gross estate of the decedent shall be determined by including the value at the time of his death of all property, real or personal, tangible or intangible wherever situated, except real property situated outside the United States—

(a) To the extent of the interest therein of the decedent at the time of his death;

* * * * * * *

(c) To the extent of any interest therein of which the decedent has at any time made a transfer, by trust or otherwise, in contemplation of or intended to take effect in possesion or enjoyment at or after his death, or of which he has at any time made a transfer, by trust or otherwise, under which he has retained for his life or for any period not ascertainable without reference to his death or for any period which does not in fact end before his death (1) the possession or enjoyment of, or the right to the income from, the property, or (2) the right, either alone or in conjunction with any person, to designate the persons who shall possess or enjoy the property or the income therefrom; except in case of a bona fide sale for an adequate and full consideration in money or money's worth. Any transfer of a material part of his property in the nature of a final disposition or distribution thereof, made by the decedent within two years prior to his death without such consideration, shall, unless shown to the contrary, be deemed to have been

made in contemplation of death within the meaning of this title.

(d) (1) To the extent of any interest therein of which the decedent has at any time made a transfer, by trust or otherwise, where the enjoyment thereof was subject at the date of his death to any change through the exercise of a power, either by the decedent alone or in conjunction with any person, to alter, amend, or revoke, or where the decedent relinquished any such power in contemplation of his death, except in case of a bona fide sale for an adequate and full consideration in money or money's worth.

* * * * * * *

(g) To the extent of the amount receivable by the executor as insurance under policies taken out by the decedent upon his own life; and to the extent of the excess over $40,000 of the amount receivable by all other beneficiaries as insurance under policies taken out by the decedent upon his own life.

* * * * * * *

(U. S. C, A., Title 26, Sec. 411.)

Article 25 of Regulation 80 (1937 Ed.):

Art. 25. TAXABLE INSURANCE—The statute provides for the inclusion in the gross estate of insurance taken out by the decedent upon his own life, as follows: (a) All insurance receivable by, or for the benefit of, the estate; (b) all other insurance to the extent that it exceeds in the aggregate $40,000.

The term "insurance" refers to life insurance of every description, including death benefits paid by fraternal beneficial societies, operating under the lodge system. * * *

FILED
DEC 10
CHARLES ELMORE

IN THE

Supreme Court of the United States

OCTOBER TERM, 1940.

NO. 371.

ESTATE OF ANNA M. KELLER, PIUS P. KELLER and MARCELLA V. KELLER, Executors,
Petitioners,

v.

COMMISSIONER OF INTERNAL REVENUE.

BRIEF FOR PETITIONERS.

On Writ of Certiorari to the United States Circuit Court of Appeals for the Third Circuit.

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Petitioners,

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COMMISSIONER OF INTERNAL REVENUE.

BRIEF FOR PETITIONERS.

OPINIONS BELOW.

The opinion of the Board of Tax Appeals is reported in 39 B. T. A. 1047, and appears at pages 19 to 36 of the Record. The Opinion of the Circuit Court of Appeals for the Third Circuit (Clark, C. J.) is reported in 113 F. 2d (Advance Reports No. 5) 833, and appears at pages 71 to 77 of the Record.

JURISDICTION.

The judgment of the Circuit Court of Appeals was entered on May 28, 1940. No petition for rehearing was filed. The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code as amended by the Act of February 13, 1925, 28 U. S. C. A., §347 (a). The petition for writ of certiorari was filed on August 23, 1940 and the writ was granted October 14, 1940 (R. 78).

QUESTION PRESENTED.

The Exemption from Estate Taxation Given to a Limited Amount of Life Insurance by Section 302 (g) of the Revenue Act of 1926, as Amended, Is Not Affected by an Insurance Company's Requiring the Taking Out of a Separate Annuity Contract as a Condition Precedent to the Issuance of a Standard Form Life Insurance Contract.

STATUTE AND REGULATIONS INVOLVED.

The pertinent statutory provisions and Regulations will be found in the Appendix, *infra,* pp. 36 and 37.

STATEMENT OF THE CASE.

This proceeding was initiated when petitioners filed a petition with the United States Board of Tax Appeals for a redetermination of a deficiency which the Commissioner of Internal Revenue had determined to be due from petitioners as additional estate tax.

THE QUESTION INVOLVED.

The question presented by the record is one of exemption from estate taxation, viz: Upon the death of a decedent who in her lifetime executed on the same day a single premium life insurance contract on the company's standard form and a single premium annuity contract also on the company's standard form; is the amount (being less than $40,000) received by the life insurance beneficiary, solely on the life insurance policy, "insurance" as that term is used in Section 302 (g) of the Revenue Act as amended, and accordingly exempt from estate taxation and excludible from decedent's gross estate?

The Board of Tax Appeals reversed the Commissioner and held that the amount was life insurance and that there was no deficiency in estate tax. The Board's Findings of Fact will be found in the Record, pp. 9-18 and the Opinion, pp. 19-36.

The United States Circuit Court of Appeals for the Third Circuit reversed the Board of Tax Appeals. (R. 71-77.)

THE FACTS FOUND BY THE TAX BOARD.

The facts as found by the Board of Tax Appeals are substantially as follows (R. 10-18):

Petitioners are the executors of the estate of Anna M. Keller, deceased. The decedent died March 28, 1936. (R. 10-11.)

(a) *The Annuity Contract.*

On December 31, 1934, the decedent, at the age of 75, executed a contract with the Equitable Life Assurance Society of the United States, sometimes hereinafter referred to as the insurance company. The contract is designated "Life Annuity. Single Premium. Non-Participating" and provides for the payment of a single premium of $3,258.20 to the insurance company in consideration for semi-annual annuity income payments of $195.42 by the insurance company to the annuitant during her lifetime. The contract was on the regular standard form used by the insurance company for writing annuity contracts, and among other things provided that "this agreement, and the application therefor, a copy of which is endorsed hereon or attached hereto, constitute the entire contract between the parties." (R. 10-11; Exhibit "C.")

(b) *The Life Insurance Contract.*

On the same day that the annuity contract was executed, the decedent also executed a policy or contract with the insurance company for the face amount of $20,000 which was designated as "Single Premium Life Policy. Insurance Payable at Death. Single Premium. Annual Dividends." The policy was on the regular standard form used by the insurance company for writ-

ing life insurance policies. This insurance was granted in consideration of the payment in advance to the Society of a single premium of Seventeen thousand nine hundred forty-one and 80/100 Dollars. (R. 11-12; Exhibit "D.") The policy named decedent's daughter as the beneficiary.

This policy also contained provisions relating to assignments, change of beneficiary, policy years, age and self-destruction. There was a provision captioned "The Contract" which provided as follows (R. 12-13): "This policy, and the application therefor, a copy of which is endorsed hereon or securely attached hereto, constitute the entire contract between the parties. * * *." The policy also contained a "Table of Loan and Cash Surrender Values for each $1,000 of Face Amount."

(c) *Company's Risk Not Eliminated on Insurance Contract.*

The company accepted in lieu of a medical examination the issuance of the life annuity contract, through which the company reduced but did not entirely eliminate its risk against loss due to premature death. (R. 14.) The insurance company would not have issued the insurance policy to the insured at her attained age of 75 years without issuing a life annuity contract in conjunction with the insurance policy but in computing the single premium paid for the life insurance contract, no adjustment was made for the amount received as a premium for the annuity contract. The consideration charged for the annuity contract would have been the same even if no life insurance had been purchased at the time and the decedent could have obtained the annuity contract without the insurance policy, in which case the annuity would have been identically the same

as in the annuity contract which was issued to the decedent. The requirement of the annuity contract as a condition precedent to the issuance of the insurance policy was due to the amount of risk involved, namely, the difference between the consideration and the death benefit. (R. 14.)

The total consideration paid by the decedent to the insurance company for the two contracts amounted to 106 percent of the face amount of the insurance policy or $21,200, which was $1,200 in excess of the face amount of the insurance policy. The name given to the $1,200 by the insurance company is "loading" and is for the purpose of paying commissions to the general agent and the special agent and for premium taxes. The actual expense exclusive of any profit and general overhead expense of the insurance company in issuing the two contracts in question was $1,475.97.

The above total charge of 106 percent on this type of contracts was later found to be unprofitable, at which time the charge was increased by the insurance company to 110 percent, and still later the issuance of an insurance policy like the one in question was made conditional upon a medical examination. (R. 14-15.)

The insurance company at all times treated the two contracts entered into with the decedent on December 31, 1934, as two separate transactions rather than as one transaction. (R. 15.) The company in its reports to the State Commissioner of Insurance listed the contracts separately—one under the life insurance group and the other under the annuity group. (R. 15-16.)

(d) *No Contemplation of Death.*

The principal cause of decedent's death was cerebral hemorrhage of one-half day duration. Up until the time of her last illness the decedent had enjoyed excellent health, had been remarkably free from any illnesses or disabilities, had been especially active for one of her years, enjoyed life and never expressed any expectancy of dying, nor mentioned death. Her mother and her grandmother were both in their nineties when they died. (R. 18.)

TAX BOARD HOLDS AMOUNT PAID IS INSURANCE.

The Commissioner included the proceeds of the life insurance in decedent's gross estate, claiming the entire transaction represented a transfer made to take effect at or after death, in accordance with the provisions of Section 803, Revenue Act of 1932, which amended Section 302 (c); Revenue Act of 1926, and imposed a deficiency in estate tax of $3,243.64. (R. 6-7.) The Board of Tax Appeals reversed this determination, holding that the proceeds of the life insurance is not includible in the decedent's gross estate as a transfer made in contemplation of death, or otherwise, and that the amount so paid represents "insurance under policies taken out by the decedent upon her own life" as that term is used in Section 302 (g) of the Revenue Act of 1926, as amended. (R. 26.) The Circuit Court of Appeals reversed the decision of the Board of Tax Appeals. (R. 76.)

SPECIFICATION OF ERRORS.

1. The Circuit Court of Appeals erred in reversing the judgment of the Board of Tax Appeals, and in reinstating an estate tax deficiency of $3,243.64.

2. The Circuit Court of Appeals erred in holding that petitioner was not entitled to deduct the proceeds of the life insurance policy from the decedent's gross estate.

3. The Circuit Court of Appeals erred in failing to give proper effect to Section 302 (g) of the Revenue Act of 1926, as amended (U. S. C. A. Title 26, Section 411), and Article 25 of Regulation 80 (1937 Ed.), which exempts from estate taxation the $20,030.43 proceeds of the life insurance policy taken out by the decedent on her own life and paid to decedent's daughter as beneficiary, inasmuch as decedent had no other life insurance.

4. The Circuit Court of Appeals erred in not accepting the following issues of fact resolved by the Board of Tax Appeals which were sustained by substantial evidence:

(a) The fact found by the Board of Tax Appeals that the issuance of the annuity policy reduced *but did not eliminate the company's risk* against loss due to premature death. (R. 14-15.)

(b) The fact found by the Board of Tax Appeals that decedent was not in contemplation of death when she took out the policy in question. (R. 9.)

(c) The fact found by the Board of Tax Appeals that the proceeds paid by the company to the

beneficiary of the policy was "insurance". (R. 18.)

5. The Circuit Court erred in ignoring the legal and contractual aspects of the life insurance contract, and in only considering possible *economic* effects of the two contracts. (Opinion, R. 74-75.)

6. The Circuit Court of Appeals erred in concluding "the Congress used the word 'insurance' with the economic rather than the purely contractual aspects of the term in mind." (Opinion, R. 75.)

SUMMARY OF ARGUMENT.

The life insurance policy involved in this case is as complete in and of itself as any contract of life insurance could be. It is conceded on all sides that were this contract the only one executed between the decedent and the company, it would be unquestionably a contract of life insurance and the $20,030.43 paid to the beneficiary on decedent's death would clearly represent "insurance" as the term is used in Section 302 (g) of the Revenue Act of 1926, as amended, and would therefore not be included in decedent's gross estate.

However, the Commissioner claims that this insurance contract cannot be considered as a contract of life insurance because it was written in conjunction or simultaneously with another separate contract. This other contract was an annuity policy. This annuity policy is also complete in and of itself, as much as any annuity could be.

It is conceded by both sides that because of the decedent's age, she would not have been issued the life insurance contract had she not taken out the annuity contract, and that upon her taking out both contracts no medical examination was required (R. 18).

Petitioners contend that the taking out of the annuity policy was required by the company as a condition precedent to issuing the insurance policy but that once this condition precedent was complied with, the two policies thenceforth were separate, distinct, independent contracts, and that this appears from their context, from the intention of the parties, and from the manner in which each policy and the premiums received thereunder were treated by the insurance company. Petitioners also contend, and the Tax Board so found (R. 14), that the company's requirement of the annuity as a condition precedent for issuing the life insurance was for the purpose of reducing the company's risk on the life insurance policy but that it did not eliminate said risk.

The Tax Board has found the facts in accordance with petitioners' contentions; and as these facts are supported by substantial evidence, the Appellate Court must accept them as resolved by the Tax Board.

Accordingly the proceeds of the life insurance policy paid to the beneficiary represent "insurance" as that term is used in Section 302 (g) of the 1926 Revenue Act, as amended, and they are excludible from decedent's gross estate.

ARGUMENT.

POINT I.

The Insurance and the Annuity Policies Were Separate Contracts, Neither Being Merged in the Other, and Each Retaining Its Insurance and Annuity Features Respectively, Despite the Fact That Both Contracts May Be Considered to Have Been Applied for in Connection With One Transaction.

Although the issuance of the respective life insurance and annuity contracts may be considered as constituting one transaction and the separate policies may therefore be construed in relation to each other, they cannot be considered as being merged into one single indivisible contract, nor do they lose their separate and distinct contractual features. A single transaction may often consist of two or more entirely separate, distinct and independent formal contracts. A common example is the single transaction between a mortgagor and a mortgagee where both a mortgage and a bond are given as security for the money loaned. Although the mortgage and the bond are issued in conjunction with each other and form part of a single transaction, they do not lose their separate contractual attributes and cannot be merged into one instrument, and even if the mortgage should prove worthless because of a flaw in the title or for some other reason, the bond would still remain a separate contract upon which the mortgagee could seek to recover the amount due.

But the two policies in the case at bar are even more separate, independent and severable contracts than the above illustration. Whereas the extinguish-

ment of all debt, whether accomplished by resort to the mortgage or to the bond, would cause the other instrument to become null and void, the life insurance policy in the case at bar could be surrendered for its cash surrender value and thus be terminated without in any way affecting the annuity contract any more than if the life insurance had never been issued.

Williston, On Contracts, 1936 Ed. Vol. III p. 1801 in the chapter on general rules for interpretation, or construction of contracts, *section 628* states:

> "* * * Even where a writing does not refer to another writing, if such other writing was made as part of the same transaction, the two should be construed together. It is usually said that the two writings together form one contract. Though this is generally true, it is not always accurate, even though the several writings are part of the same bargain. Where one of the writings is a formal document it cannot be incorporated in an ordinary writing. *A note and a mortgage to secure it are not strictly one contract,* though doubtless each is to be construed in connection with the other in order to determine its meaning. * * *" (R. 21.) [Italics ours.]

It is difficult to imagine two contracts, forming one transaction, more independent and severable both in form and fact than the two policies in question. Both were written on the respective regular standard forms (R. 11) and each was based on the mortality table customarily used in writing life and annuity policies, respectively. (R. 16). Neither contract contains any reference, directly or indirectly, to the other, but on the contrary, each provides that the agreement and the respective applications therefor "constitute the entire contract between the parties" (R. 11, 12). The insured

could exercise her rights under the life insurance contract irrespective of the existence of the annuity contract, and vice versa. She had the right to surrender the life policy for its cash value and thus terminate it, as well as the right to borrow upon it or assign it (R. 12, 13). Either the life insurance or the annuity policy could be sued on and enforced by itself.

Not only are the policies separate and distinct contracts according to their form, but they were so looked upon and so treated by the parties executing them.

Guy T. Helvering, Commissioner of Internal Revenue, v. Edyth LeGierse et al., 110 Fed. (2d) 734 (Second Circuit) (1940). This case involves practically identical policies and the same legal question as the case at bar. In the Circuit Court's opinion, which conflicts with that of the case at bar, the Court said (p. 735):

> "* * * Here the undertakings of the insurance company were obviously intended to be separable and independent. A separate application was made for each policy, a separate consideration paid for each, neither policy made reference to the other, and either could have been assigned, and the life policy could have been surrendered, without affecting the insurance company's obligations under the other. In these respects the situation is unlike that presented in *Old Colony Trust Co. v. Commissioner*, 102 F. (2d) 380 (C. C. A. 1) upon which the petitioner strongly relies. In substance as well as in form the policies issued to Mrs. LeGierse were independent contracts. In the life policy she took out insurance upon her life which is squarely within the exemption granted by the statute. The fact that she could not have gotten that policy unless she had also bought an annuity contract does not change the character of what she got."

The insurance company at all times treated the two contracts as two separate transactions and instruments instead of as one. (R. 15). Both on the company's records and in their reports, required by law, to the Superintendent of Insurance of the State of New York, the proceeds and liability with respect to the life insurance policy were included in their life insurance records and reports, and those relating to the annuity policy, in their annuity records and reports. Even in computing the amount of the premium to be charged for the policies, the computation for each was made without reference to the other, and each was on the same basis as if the other policy had not been taken out. (R. 15, 16).

Although it is conceded that because of the age of the insured the insurance company required the taking out of the annuity contract before it would issue the life insurance policy, this, as the Board of Tax Appeals found as a fact (R. 14), was merely a condition precedent imposed by the company for the purpose of reducing but not eliminating its risk. But once this condition precedent was complied with, the insurance policy became just as much a life insurance contract as any other policy issued on the same standard form.

Insurance companies have a right to require certain reasonable conditions precedent before they will issue a certain type of policy, but once this condition precedent is complied with the contract must be interpreted in accordance with what it actually is. For example, must insurance companies, especially in Pennsylvania, do not like to write Workmen's Compensation policies, and before writing them require the concern desiring such a policy to also take out with the company a Public Liability policy, in an amount large enough to make it worth while for the company to write the Compensation policy. Certainly it could not be claimed that because

the insurance company required the two policies to be taken out simultaneously, and because unless the Liability policy is taken out, they would not issue the Compensation policy, that therefore, because the two policies are issued as one transaction, each policy loses its separate characteristics, and the respective Liability and Compensation policies become merged into a single indivisible contract, or that the premiums paid for the two policies are to be considered as one lump sum.

Another example of a condition precedent required by insurance companies is in that type of policy designated as "Salary Saving" life insurance. This type will not be issued to less than 30 appl. ants and it is issued in face amounts up to $5,000 without the requirement of a medical examination. But if one individual applies for such a policy, the insurance company demands 29 additional similar policies from 29 other individuals before writing such a policy. However, once this condition precedent is met and 30 applications are received and the policies are written simultaneously or as one transaction, thenceforth each of the 30 policies are unquestionably separate, distinct, individual life insurance contracts issued to the 30 respective applicants.

The Board of Tax Appeals, in disposing of this point, says (R. 24):

> "* * * It seems to us that the situation is simply this: Even assuming that Mrs. Keller did not want to purchase an annuity (and we have no evidence to that effect) and only did so because she had to do it to secure the life insurance policy which she did want, nevertheless when the purchase was complete she owned two contracts and we have no cause to say that her life insurance policy was not life insurance merely because she had to purchase an

annuity policy along with it. We are cited to no authority which would compel any such holding."

Legg v. St. John, 296 U. S. 489. The Board of Tax Appeals in citing this case, states as follows (R. 22):

"In Legg v. St. John, supra, the question before the Supreme Court was whether Legg, a voluntary bankrupt, or his trustee was the person entitled to certain future monthly disability benefits payable under a contract entered into between Legg and an insurance company before the adjudication. Several years prior to the adjudication Legg took out a life insurance policy under which the company agreed, in consideration for a stated annual premium, to pay a certain amount upon his death. By a supplementary contract issued on the same day and attached to the policy, the company, in consideration for an additional annual premium of a stated amount, agreed to pay a monthly benefit of $174.52 upon due proof of total and permanent disability, which latter event happened several years before the adjudication. In holding that the disability benefits were payable to the trustee and not to the bankrupt, Mr. Justice Brandeis in the course of his opinion said:

'Second. The fact that the disability benefits are provided for in a "Supplementary Contract" issued on the same day as the policy and physically attached thereto does not make them life insurance. The life policy and the contract were executed as distinct instruments. The "Supplementary Contract" was to operate for some purposes as if a part of the life policy. But for all other purposes it is a separate obligation. The hazards covered by the two instruments are obviously different. The bene-

ficiaries differ also. The payment under the life policy was to be made to the wife; the disability benefits are to be paid to Legg himself. A separate and different premium was exacted for the obligations assumed in each instrument. It was provided that forfeiture of the life policy would terminate all rights arising from disability; but the supplementary contract could be terminated by Legg without affecting otherwise his life policy.' "

The Seefurth Service is a standard work extensively used by insurance companies as an acknowledged authority on insurance law and taxation. This Service, on page 21 of the 1937 Reference Volume, declares as follows:

"We have been informed of cases where the internal revenue department has taken the position that the $40,000 insurance exemption should not be allowed with respect to single premium policies taken out in conjunction with life annuities without medical examination. No published ruling has been issued, but, in the event such a ruling should be issued, it is difficult to see how it can be upheld by the U. S. Board of Tax Appeals and the courts, in the face of the broad provision in the estate tax law to the effect that proceeds of insurance, payable to a beneficiary, other than the executor or administrator, shall be excluded from the gross estate to the extent of $40,000.

There is no exception in the statute which would bar policies, whether annual premium or *single premium,* and whether *issued on a medical or non-medical basis,* and *whether or not issued in conjunction with an annuity policy.* As long as the life insurance policy comes within the true terms of an insurance policy it would seem clear that the

$40,000 exclusion from estate tax must be granted. *Insurance policies issued in conjunction with annuities are the same insurance policies that are issued separately upon a medical examination, and, until the law is changed, any denial of the exclusion would seem to be reading into the law a provision which does not exist.*" [Italics ours.]

Bowman v. Tax Com., 135 Ohio St. 395 (decided April 26, 1939). The following is quoted from paragraph 2 of the syllabus—page 295:

"2. A contract between an insurance company and a person called the assured, whereby, in consideration of a single cash premium paid by the assured to the company, a policy is issued to the assured wherein a part of the single cash premium paid is allotted to life insurance on the life of the assured, and a part of such single cash premium is allotted to an annuity contract, with a guarantee that upon settlement there will be paid to the assured, or in case of his death to his beneficiary, a sum approximately equal to the original cash premium, and in addition a monthly annuity during the life of the assured or until settlement, plus such dividends as may be allotted by the company out of its surplus interest earnings on such contract, *is a divisible insurance and annuity contract, the insurance feature of which is exempt from taxation;* * * *" [Italics ours.]

POINT II.

The Two Premiums Paid by the Insured Purchased Separate and Distinct Life Insurance and Annuity Contracts, Respectively, and These Premiums Cannot Be Construed as a Lump Sum Deposited With the Company for Investment Purposes.

The facts do not support the Commissioner's contention that the company merely received a lump sum for investment purposes. Such a finding could only be reached by substituting a pure fiction for the specific terms of the contracts, the clear intention of the parties, and the separate manner in which the respective premiums were treated. The Tax Board said in its Opinion (R. 23):

> "In the instant proceeding we think the agreement between the decedent and the insurance company as evidenced by the two documents, the insurance policy and the annuity contract, shows an intention on the part of the contracting parties to enter into an insurance and annuity contract with clearly severable features as to each, *rather than a contract of trusteeship with no separate features.*" [Italics ours.]

And again the Tax Board said (R. 23):

> "* * * Attention is called to these features in order to show the clear separability of the two contracts notwithstanding that they were taken out as parts of one transaction. *The writings did not take the form of any declaration of trust. No provision was made for any compensation to be paid the insurance company as trustee.*" [Italics ours.]

As one of the members of the Tax Board ably states in his concurring Opinion (R. 27):

"* * * Nor is it material in this case that the insurance company executed a life insurance contract in conjunction with an annuity contract. Insurance companies sell many types of insurance which combine life insurance with other benefits such as annuity payments. Such policies have various names, such as endowment policies. In the instance before us, the insurance company executed two policies, one an annuity policy. To the insurance company, there were two contracts having separate terms and separate benefits. Upon the death of the insured the annuity contract terminated and nothing passed under this contract to decedent's beneficiary. May we go outside the terms of executed contracts fully performed and decide the question as though the parties had executed a different contract or contracts? I believe we may not do so, at least where the contracts are bona fide."

In the case of *Bodine v. Commissioner,* 103 F. (2d) 932, although the premium paid was on a single annuity contract with death benefit, the Court held (Syl. 7, page 982):

"A life annuity policy with death benefit, for which applicant paid a single premium, and which entitled him to monthly payments until death or surrender of policy in return for payment of principal sum, could not be regarded for income tax purposes as a contract providing merely for deposit of a fixed principal sum payable to depositor on demand or at death with a guaranteed return of a certain percent."

Respondents therefore insist that what the insured paid and what the company received for the two separate policies were two separate premiums, one for the life insurance and the other for the annuity. This is in

accordance with the unequivocal terms of the contracts, the intention of the parties, and the company's allocation of the premiums themselves.

POINT III.

There Was a Risk to the Insurance Company in Issuing the Insurance Policy, and the Annuity Did Not Eliminate the Risk.

As the facts are undisputed as to what was done between the parties and as to the specific terms of the policies, and inasmuch as the premiums clearly state what sums the company received from the insured for the policies, and the policies show what payments to the insured or her beneficiary were to be paid thereunder by the company, the question of whether the company had a risk or not is undoubtedly one of fact and not one of law.

The Tax Board in its "Findings of Fact" (R. 14, 15) found that the company did have a risk of loss. The following are quotations from said Findings of Fact:

> "The company accepted in lieu of a medical examination the issuance of the life annuity contract, through which the company reduced but did not entirely eliminate its risk against loss due to premature death." (R. 14)
>
> "The requirement of the annuity contract as a condition precedent to the issuance of the insurance policy was due to the amount of risk involved, namely, the difference between the consideration and the death benefit. * * *
>
> The above total charge of 106 percent was later found to be unprofitable, at which time the charge was increased to 110 percent, and still later the issu-

ance of an insurance policy like the one in question was made conditional upon a medical examination." (R. 14)

The Tax Board found in its Findings of Fact (R. 14), without figuring any profit and without allowing anything for overhead expense, that the insurance company s actual expense for commission, expense allowance to general agent, and premium tax on the two policies totaled $1,475.97. Your petitioners do not agree that the two separate premiums can be properly or lawfully lumped together, but even if this were done, they only amount to $1200.00 more than the $20,000 face amount of the insurance policy. Accordingly, if the insured had died prematurely, prior to life expectancy, within a few days after taking out the two policies, the insurance company upon paying the $20,000 face amount of the life insurance would have had an out-of-pocket loss of $275.97 *in addition to the loss of general overhead expense and the loss of any profit.*

Insurance companies are conceded to have the right to charge premiums at a rate which will enable the earning of a reasonable profit, as well as cover general overhead costs and actual out-of-pocket expenses. Therefore, if a company receives such insufficient premiums (even under the false lump sum theory) from a life insurance policy and an annuity policy taken out the same day so that in the event of the premature death of the insured the company not only fails to make a profit and collect its general overhead expenses but, in addition, has to pay but almost $300 in cash more than the premiums received, there is obviously the risk of such a premature death assumed by the company in writing the life insurance policy, and the annuity policy does not eliminate it.

Your petitioners do not agree that the two separate premiums for the insurance and annuity policies, respectively, can be properly or lawfully lumped together, and on the contrary insist that the two premiums must at all times be considered separately and independently. Nevetheless, the above arithmetical calculation, taken from the Tax Board's Findings of Fact, (R. 19, 20), serves as just *one* illustration of how the insurance company, even under the lump sum theory, had a risk of loss due to premature death prior to the life expectancy. Other illustrations could be given as to the risk in case the insured had surrendered the insurance policy for its cash surrender value and yet continued to receive the annuity payments.

But to appreciate all the elements of risk involved in insurance requires a complete understanding of the complicated science of insurance underwriting. What is an insurable risk differs from time to time, from amount to amount, from individual to individual, and even between various companies. It is customary for companies to write insurance of different types without the requirement of a medical examination up to certain amounts. Even when a medical examination is required and successfully passed, companies will not write more than up to a limited sum on one individual, and even then when the amount they do write exceeds a certain figure, the excess is often underwritten with other companies, even without the insured's knowledge.

Some companies refuse to insure those engaged in certain hazardous occupations as constituting too great a risk, while other companies readily insure them. Some even refuse to insure women, while others have no such hesitation and even ccept so-called "sub-standard risks" at increased premiums. But despite the good or poor risk of any type of policy, a company may desist writing any more of that type merely in order to preserve a

proper balance or diversification of risks. In fact, all insurance involves a balancing of risk, and this is often accomplished by spreading the risk and coverage over a number of policies of various types so as to obtain the proper actuarial average and thus neutralize and, in fact, eliminate the risk on the total policies written. It is only such an elimination of risk that enables insurance companies to continually earn profits and distribute dividends.

As has been stated and as the above mathematical calculation illustrates, the question of whether the insurance company in the case at bar had a risk is one of fact and not one of law. In support of the Tax Board's finding that there was a risk there is an abundance of substantial evidence, and there is no evidence to the contrary. This clearly appears not only by the foregoing calculation but also from the following quotations from the "Statement of Evidence" (R. 41-69):

(R. 53-54)

F. J. Stevenson (an officer of the Equitable Company's general agent)—Direct.

"* * * The issuance of that contract on the same date as the insurance and execution of the life insurance policy did not eliminate the risk. When I say 'hedging it' I mean instead of eliminating it, it reduced the risk.

* * * * * *

'Q. Now, it is stated in the opening statement, that the Equitable Company had no risk. Was this policy found profitable, a life insurance policy of this type, where an annuity policy was a condition precedent, was that found so profitable to the company that it continued it?

A. It was not profitable. The basis on which we issued those policies was changed so

that instead of their having been collected as $600.00, as was the case here, or, rather, $1200.00, the amount was raised to $2000.00 subsequently, and then later the issuance was made conditional upon medical examination.'

I believe those changes were required in the increasing of the premium and in the requirement of physical examination because the company had too great a risk in the method they had operated at the time of these two policies."

The Tax Board having resolved in the affirmative, the question of whether the insurance company had a risk in writing the life insurance policy in the case at bar, and there being substantial evidence to sustain this Finding of Fact, the Circuit Court had no other alternative than to accept such finding.

Helve ing v. Kehoe, 84 U. S. L. Ed. (Advance Reports) 498 (1940):

"Upon review the court may not substitute its judgment of the facts for that of the Board. When there is substantial evidence to support the conclusion of the latter this must be accepted."

Helvering v. Rankin, 295 U. S. 123 (79 L. Ed. 1343). Opinion by Mr. Justice Brandeis at page 131:

"Fourth. The Court of Appeals is without power, on review of proceedings of the Board of Tax Appeals, to make any findings of fact."

Not only must the courts accept the Tax Board's findings of fact, when supported by substantial evidence, but in considering whether the substantial evidence sustains such findings and if they have been resolved in the taxpayer's favor, the Court must assume that all facts that the evidence of the taxpayer *tends to*

prove are established, and *all inferences fairly deducible from such facts must be drawn in the taxpayer's favor.*

Helvering v. Johnson, 104 F. (2d) 140 (June 1, 1939), opinion at page 141:

> "The issues of fact having been resolved by the Board in the respondent's favor, the question before this Court is whether the ultimate finding of the Board is sustained by substantial evidence. In considering that question we think that *all facts that the respondent's evidence reasonably tends to prove must be assumed to be established and all inferences fairly deducible from such facts must be drawn in his favor,* and that effect must be given to the rule that issues depending upon the credibility of witnesses and the weight of evidence are to be decided by the triers of the facts." [and see the several cases cited] [Italics ours]

The Circuit Court, refusing to accept the finding of the Tax Board that the insurance company did assume a risk in the writing of the life insurance policy, and in order to make contrary findings, resorted to certain mathematical calculations not properly applicable to the facts in the case. If, during the hearing before the Tax Board, such calculations had been offered in evidence by the Commissioner, the taxpayer would have had an opportunity to rebut them and show their fallacies and inaccuracies in their application to the case at bar. In its opinion (R. 73), the Circuit Court says:

> "* * * The obligation of the borrower may be divided into a complete annuity of $2 combined with a whole life insurance of $100. One merely substitutes for the ten year term a series of probabilities of being alive (annuity) and of being dead (life insurance) in the future. The relation between these converse probabilities is such that the dis-

counted sum required to provide the annuity plus that required to produce the life insurance will always be equal to the amount of the loan. We say always because the relation between the probabilities of living and dying is from the very nature of the mortality tables, on which they are calculated, constant, no matter what the age of the lender. So, an insurance company may borrow $100 at 2% from one doomed to die within ten minutes and issue in return a $2 annuity and a $100 life policy. By an actuarial tour de force (because the continuance of life is a matter of minutes, not probabilities) the amount of the loan advanced is split into the single premiums appropriate to each policy if taken out by a normal person. In other words, the sure thing (loar) is artificially separated into doubtful bet (life insurance) and hedge (annuity). It is on this general principle that an uninsurable life becomes 'insured'."

In other words, the Court added the two premiums paid on the life and annuity policies respectively, and taking this lump sum, treated it as though this sum was to remain continuously with the insurance company until decedent's death and then treated it on the basis of an investment, or in the light of an annuity. The Court, however, failed to take into consideration the important fact that the insured could have, during her life, surrendered the life insurance policy for its cash surrender value and then, if she had lived for more than 13 years, or past the age of 86, which is only 3 years longer than the average according to the mortality table used for annuities, (and it will be remembered her mother and grandmother both lived well into the nineties), she would have received, during the remainder of her life, her annuities notwithstanding the cancellation of the life insurance policy. Under such a situation, which was clearly possible, the calculations of the Court would be

inapplicable because the insurance company's funds would have been entirely exhausted upon the insured reaching the age of 86. We submit in the Appendix, page 38, Calculations, to fit such a situation, and an examination thereof will show that if the policy was surrendered for its cash surrender value a year after its issuance, and if the insured continued to live till the age of 95, the insurance company would have paid out more than $3400 in excess of what it had received on the premiums, including interest thereon, in addition to the company's loss of profits and any amount covering overhead.

Another error in the aforesaid calculations of the Circuit Court was its assumption that all the insurance company would pay on the life insurance policy was the principal amount of $20,000, and the fact that the company also paid annual dividends on such policies was entirely overlooked. These dividends would have amounted in ten years to between $1200 and $1500. (R. 17)

The Circuit Court was also in error in stating (R. 73):

> "* * * the relation between the probabilities of living and dying is from the very nature of the mortality tables, on which they are calculated, constant, no matter what the age of the lender."

The fact, as found by the Tax Board (R. 14), is that the standard mortality table used by the insurance company as the basis for the annuity rate for one of Mrs. Keller's age on her annuity policy has a 40% greater life expectancy than the standard mortality table used to compute the premium on her life insurance policy. Insurance actuaries have found that persons owning annuity policies live longer on the average than those not possessing such policies.

Petitioners, therefore, contend that the aforesaid calculations in the Circuit Court's opinion do not properly apply to the case at bar and are certainly insufficient to refute the finding of the Tax Board sustained by substantial evidence, that the insurance company did assume a risk even if the Court had the power to set aside such finding.

Therefore, it cannot be claimed that the life insurance policy was not a life insurance policy because there was no risk.

POINT IV.

Section 302 (g) of the Revenue Act of 1926, as Amended, Uses the Term "Insurance" in Its Legal Sense and With Its Contractual Aspects in Mind and Not With a View to the Economic Method Whereby the Amount Is Received.

The Circuit Court, in ignoring the legal and contractual aspects of the life insurance policy, relies upon the following two false premises: (1) that the insurance company assumed no risk; and (2) that the decedent was uninsurable. The company's actual assumption of a risk has been discussed above.

As to the allegation that the decedent was uninsurable, the authorities given therefor were a life insurance salesman's tract and the fact that no physical examination was required. Different insurance companies have different age limits beyond which they decline to write life insurance unless certain extra conditions are complied with. Suppose a company ceased writing insurance on persons over 75 years of age and later reduced the age limit to 70 but provided that those above that age seeking insurance be required to take out an annuity policy, as in the case at bar, in lieu of a physical examina-

tion. In these days of increased longevity, due to improving health conditions and the rapid medical progress in discovering new preventatives and cures, the annuity policy might be considered by the company a safer means of reducing or partly hedging its risk in the event of death than a physical examination. Certainly because the annuity policy was required as a condition precedent to issuing a life insurance policy instead of a physical examination, this would not justify the conclusion that the applicant was uninsurable.

There are many kinds of life insurance written by companies wherein a physical examination is not required. If an individual who, because of high blood pressure or some other physical defect, should hesitate to apply for a type of life insurance requiring a physical examination lest he be rejected and should obtain one of these other types of policies wherein a physical examination was not demanded, and in lieu thereof some other condition precedent required (*i.e.* group insurance), that would not justify a contention that the individual was uninsurable and therefore the policy obtained by him was an investment instead of insurance. In fact, if the decedent in the case at bar was uninsurable and the Equitable Company considered her as such and nevertheless accepted from her what purported to be on its face a premium for life insurance, whereas the funds were really received merely for investment purposes, the company would be violating the insurance laws of every state wherein they sold such policies. Such a violation should not be presumed.

In its opinion, the Circuit Court says (R. 74):

"We think the question turns upon whether the adverbial phrase 'as insurance' refers to the legal, or to the economic method, whereby the amount is received. The legal mechanism employed at bar is

> unquestionably a contract of life insurance. * * * It is plain in our estimation that the Congress used the word 'insurance' with the economic rather than the purely contractual aspects of the term in mind."

The Circuit Court admits that according to its legal significance and from its contractual aspects, the life insurance policy "is unquestionably a contract of life insurance."

We do not know from what source the Circuit Court concluded that the Congress used the term insurance with the economic rather than the purely contractual aspects of the term in mind. In fact, an examination of the Comments by the Ways and Means Committee in its Report on the 1918 Revenue Bill will show the opposite intention from that assumed by the Court below.

The history of Section 302 (g) of the Revenue Act of 1926, as amended, is as follows. Under the 1916 Revenue Act, no insurance proceeds were taxed. Section 402 (f) of the 1918 Revenue Act (40 Stat. 1057) for the first time included in the gross estate for taxation purposes amounts received by the executor and also amounts over $40,000 received by other beneficiaries. It is interesting to note that among the comments by the Ways and Means Committee in its Report on the 1918 Revenue Bill appears the following on page 22 of House Report 767, (65th Congress, 2d Session):

> "Agents of insurance companies have openly urged persons of wealth to take out additional insurance payable to specific beneficiaries for the reason that such insurance would not be included in the gross estate. A liberal exemption of $40,000 has been included and it seems not unreasonable to require the inclusion of amounts in excess of this sum."

The same statement appears in Report No. 617 of the Senate Finance Committee, 65th Congress, 3rd Session, page 42.

It is, therefore, apparent that Congress in enacting the provision exempting $40,000 of insurance taken out upon the life of the decedent and payable to a named beneficiary had in mind its application, and expected it to apply, even in the case where a wealthy person took out the insurance with the motive of decreasing his estate tax. The Circuit Court incorrectly assumed that the only purpose of Congress in enacting the exemption was to encourage wage earners or those of moderate means in rescuing their beneficiaries within the family circle from want.

The above quoted comments by the Ways and Means Committee in its Report on the 1918 Revenue Bill refute this assumption. Moreover, it is not the individual of moderate means and the wage earner who are chiefly interested in reducing estate taxes, but in view of the specific exemption of $40,000 allowed gross estates before any Federal estate tax is payable, it is chiefly those of means who are interested in decreasing their estate taxes. Accordingly, the exemption was enacted with the knowledge and intention that it would be utilized by any to whom it was available.

Not only was it clearly the intention of the Congress that the $40,000 exemption should apply to all kinds of life insurance and irrespective of the age or the financial condition of the insured but this was also the intention of the Treasury Department.

Treasury Regulation 80 (1937 Ed.) Article 25 (U. S. C. A., Title 26, Sec. 411):

"Art. 25. TAXABLE INSURANCE — The statute provides for the inclusion in the gross estate of

insurance taken out by the decedent upon his own life, as follows: (a) All insurance receivable by, or for the benefit of, the estate; (b) all other insurance to the extent that it exceeds in the aggregate $40,000.

The term 'insurance' refers to *life insurance of every description,* including death benefits paid by fraternal beneficial societies, operating under the lodge system. * * *" (Italics ours)

If the decision of the Circuit Court should be affirmed and the Supreme Court of the United States should permit the clear legal and contractual aspects of insurance policies to be entirely disregarded and the economic effects of policies substituted therefor, then practically all types of insurance contracts would lose their contractual and legal significance and could be interpreted as investments according to whatever economic theories various courts might espouse. Several books by authoritative writers have treated insurance as investments.

"Life Insurance as Investment, Life Insurance: Its Economic and Social Relations", by Solomon S. Huebner and David McCahan (1933) states in the beginning of its preface as follows:

> "The purpose of this volume is twofold, namely, (1) to show the creative force of life insurance in the accumulation of personal estates through systematic thrift and sound investment, and (2) to explain the nature of the life insurance investment, its exceptional quality by way of solvency and investment return, and its convenience and serviceability as judged by all of the other attributes used in selecting sound investments."

If courts can ignore the legal and contractual aspects of life insurance contracts and substitute therefor whatever various economic theories ingenious minds might devise, then single premium policies, twenty-year or thirty-year endowment policies, and even straight ordinary life policies might be looked upon as investments to take effect after death. Even the ordinary yearly premium life policy becomes paid-up insurance after approximately 17 years if the insured takes it out even at as late an age as 65 and allows the annual dividends paid by the company to accumulate.

Bouvier's Law Dictionary, Baldwin students' edition, defines "law" as:

> "That which is laid down; that which is established. A rule or method of action, or order of sequences.
>
> "The rules and methods by which society compels or restrains the actions of its members."

Law is based upon precedent and although it changes from time to time, it nevertheless gives to individuals and business a reasonable guide for entering into contractual obligations. Theories of economics, however, not only vary from time to time, but two or more schools can often be found existing at the same time adopting varying or even diametrically divergent theories with the resultant opposite conclusions.

If the legal and contractual aspects of life insurance contracts can be ignored and the economic effect thereof or resulting thereunder can be substituted therefor, what is to prevent the same procedure from being followed with regard to any other contractual obligation or agreement? Such a course would leave society and business subject to whatever theory of economics the court reviewing or interpreting the contract at the time might

favor and would deprive contracting parties of the guidance and security of legal precedents and sound decisions of our courts throughout the past generations. Your petitioners accordingly contend that Congress did not use the word "insurance" with an economic rather than the contractual and legal aspect of the term in mind, that the clear legal and contractual aspects of the life insurance policy in question cannot be ignored and must be considered, and that in so doing the policy in question is one of life insurance within the exemption relied upon and its proceeds are not includible in the decedent's gross estate.

CONCLUSION.

The $20,030.43 can not be taxed because it is insurance received by the decedent's daughter, beneficiary under the life insurance policy taken out by the decedent upon her own life, and Section 302 (g) of the Revenue Act of 1926, as amended, exempts such insurance up to $40,000. Therefore, the opinion of the Circuit Court should be reversed and the opinion of the Tax Board should be affirmed.

Respectfully submitted,

FERDINAND T. WEIL,

J. SMITH CHRISTY,

Attorneys for Estate of Anna M. Keller, Pius P. Keller and Marcella V. Keller, Executors, Petitioners.

APPENDIX.

Revenue Act of 1926, c. 27, 44 Stat. 9, as amended by Section 803 (a) of the Revenue Act of 1932, c. 209, 47 Stat. 169, and by Sections 401 and 404 of the Revenue Act of 1934, c. 277, 48 Stat. 680:

SEC. 302. The value of the gross estate of the decedent shall be determined by including the value at the time of his death of all property, real or personal, tangible or intangible wherever situated, except real property situated outside the United States—

(a) To the extent of the interest therein of the decedent at the time of his death;

* * * * * *

(c) To the extent of any interest therein of which the decedent has at any time made a transfer, by trust or otherwise, in contemplation of or intended to take effect in possession or enjoyment at or after his death, or of which he has at any time made a transfer, by trust or otherwise, under which he has retained for his life or for any period not ascertainable without reference to his death or for any period which does not in fact end before his death (1) the possession or enjoyment of, or the right to the income from, the property, or (2) the right, either alone or in conjunction with any person, to designate the persons who shall possess or enjoy the property or the income therefrom; except in case of a bona fide sale for an adequate and full consideration in money or money's worth. Any transfer of a material part of his property in the nature of a final disposition or distribution thereof, made by the decedent within two years prior to his death without such consideration, shall, unless shown to the contrary, be deemed to have been made

in contemplation of death within the meaning of this title.

(d) (1) To the extent of any interest therein of which the decedent has at any time made a transfer, by trust or otherwise, where the enjoyment thereof was subject at the date of his death to any change through the exercise of a power, either by the decedent alone or in conjunction with any person, to alter, amend, or revoke, or where the decedent relinquished any such power in contemplation of his death, except in case of a bona fide sale for an adequate and full consideration in money or money's worth.

* * * * * *

(g) To the extent of the amount receivable by the executor as insurance under policies taken out by the decedent upon his own life; and to the extent of the excess over $40,000 of the amount receivable by all other beneficiaries as insurance under policies taken out by the decedent upon his own life.

* * * * * *

(U. S. C. A., Title 26, Sec. 411.)

Article 25 of Regulation 80 (1937 Ed.):

Art. 25. TAXABLE INSURANCE—The statute provides for the inclusion in the gross estate of insurance taken out by the decedent upon his own life, as follows: (a) All insurance receivable by, or for the benefit of, the estate; (b) all other insurance to the extent that it exceeds in the aggregate $40,000.

The term "insurance" refers to life insurance of every description, including death benefits paid by fraternal beneficial societies, operating under the lodge system. * * *

CALCULATION

An example of possible risk of loss to insurance company under Commissioner's lump-sum theory if the insurance policy were surrendered after the first year for its cash value.

Received by insurance company:

Net amount received by insurance company on annuity premium (after deducting commission and expense allowance to general agent)		$ 3,127.87
Interest on above amount at 4% for one year		125.11
Net amount received by insurance company on insurance premium (after deducting commission, expense allowance to general agent, and premium tax)		16,596.16
Interest on above amount at 4% for one year		663.45
Total amount in hands of insurance company at end of one year		$20,512.59

Paid by insurance company:

Annuity for one year	$ 390.84	
One year's dividend on insurance policy	122.60	
Cash surrender value of insurance policy	16,280.00	
Total amount paid by insurance company by end of first year		$16,793.44

Cash on hand at end of first year.....	$20,512.59
Cash paid out by insurance company by end of first year.....	16,793.44
Balance in company's hands for payments of future annuities after end of first year.....	$ 3,719.15

Adding to the amount of cash the company would have on hand at the end of each year 4% interest for each year, and subtracting therefrom the $390.84 annuity obligated to be paid by the company each year, would show the following amounts in the hands of the insurance company for the successive years after the cancellation of the policy as follows:

Year	*Age of Insured*	*Surplus*	*Deficit*
2nd		$3477.08	
3rd		3225.32	
4th		2963.50	
5th		2691.20	
6th		2408.01	
7th		2113.49	
8th		1807.19	
9th		1488.64	
10th		1157.35	
11th		812.80	
12th		454.47	
13th	87		$ 305.76
14th	88		696.60
15th	89		1,087.44
16th	90		1,478.28
17th	91		1,868.56
18th	92		2,259.40
19th	93		2,650.24
20th	94		3,041.08
21st	95		3,431.92

It will be noted that after the insured reaches the age of 86, the company sustains a loss each year thereafter from $305.76 at the insured's age of 87 to $3,431.92 if the insured should live to the age of 95. Furthermore, the above calculations figure the 4% interest on the amount in the hands of the company for the entire year without taking into consideration the fact that the annuities are paid semi-annually, and also inferring that the company would earn 4% interest on its funds instead of 3½% — the Tax Board's finding of fact being that the insurance company's earnings on its own funds range from 3½% to 4% (R. 17). It should also be noted that in addition to the monetary loss the company would also not receive during all these years any amount to apply on its overhead charges or profits.

Similar calculations could be made in the event of the cancellation of the policy and its being surrendered for its cash surrender value during its second, third, fourth or subsequent years.

In the event the Commissioner should claim that the above risk or loss arises out of the annuity contract and not by virtue of the insurance policy, the following should be noted: It is only by attempting to look at the two contracts as merged into one and by lumping the two premiums into one sum, which sum would be available for payments under both policies, that gives any color whatsoever to the Commissioner's claim that the company assumed no risk. Obviously, if the premiums were not so lumped together and if the insured died within a few years after the issuance of the life insurance policy, and the company could not add to the premium on this policy the premium received on the annuity policy, the company would sustain a loss on the life insurance policy. Therefore, it is not logical on the one hand to treat the two policies as combined and the two premiums as one lump sum, and then, on the other hand, if the insured lived for a number of years to then seek to separate the policies and the premiums and claim that the loss is only by virtue of the one contract.

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No. 371

In the Supreme Court of the United States

OCTOBER TERM, 1940

ESTATE OF ANNA M. KELLER, PIUS P. KELLER AND MARCELLA V. KELLER, EXECUTORS, PETITIONERS

v.

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT

MEMORANDUM FOR THE RESPONDENT

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MEMORANDUM FOR THE RESPONDENT

Although we believe the decision below to be correct, we do not oppose the granting of the writ.

The question presented is whether, when a decedent at the age of 75 takes out a single premium life insurance policy and an annuity policy, the combined effect of which is to eliminate the risk inherent in life insurance, the proceeds of the so-called insurance policy constitute an amount receivable "as insurance" within the meaning of Section 302 (g) of the Revenue Act of 1926, as amended. The decision below, as asserted by the

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petitioner, is in conflict with *Commissioner* v. *Le Gierse*, 110 F. (2d) 734 (C. C. A. 2d), in which the Government is petitioning for certiorari, No. 237, upon the basis of a conflict with the decision below as well as with *Commissioner* v. *Tyler*, 111 F. (2d) 422 (C. C. A. 8th). The Government is not opposing a petition for certiorari filed by the taxpayer in the *Tyler* case, No. 368.

Respectfully submitted.

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In the Supreme Court of the United States

OCTOBER TERM, 1940

ESTATE OF ANNA M. KELLER, PIUS P. KELLER AND MARCELLA V. KELLER, EXECUTORS, PETITIONERS

v.

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT

BRIEF FOR THE RESPONDENT

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OPINIONS BELOW

The opinion of the Board of Tax Appeals (R. 19–28) is reported in 39 B. T. A. 1047. The opinion of the Circuit Court of Appeals (R. 71–77) is reported in 113 F. (2d) 833.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered on May 28, 1940 (R. 77). The petition for a writ of certiorari was filed August 23, 1940, and was granted October 14, 1940 (R. 78). The jurisdiction of this Court rests on Section 240 (a)

of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED

The decedent at 74¾ years of age was uninsurable. However, in conjunction with her purchase of an annuity, there was issued to her a so-called single premium life insurance policy. The effect of the combined annuity and insurance policies was to eliminate the risk inherent in life insurance on the part of the insurance company and to provide decedent's beneficiary with no protection against loss resulting from death.

The question presented is whether, in these circumstances, the proceeds of the so-called insurance policy constituted an amount receivable "as insurance" within the meaning of Section 302 (g) of the Revenue Act of 1926, thereby enabling the decedent's estate to claim the special $40,000 estate tax exemption applicable to insurance.

STATUTES AND REGULATIONS INVOLVED

The pertinent statutory provisions and regulations will be found in the Appendix to the Government's brief in *Helvering* v. *Le Gierse, et al.*, No. 237, present Term, with which the present case is to be argued.

STATEMENT

The facts, as found by the Board of Tax Appeals (R. 10–18), may be summarized as follows:

Petitioners are the executors of the estate of Anna M. Keller, who died on March 28, 1936 (R.

10–11). The cause of decedent's death was a cerebral hemorrhage of one-half day's duration. Until the time of her death, decedent had enjoyed excellent health (R. 18).

On December 31, 1934, the decedent, who was then almost 75 years of age, entered into an agreement with the Equitable Life Assurance Society of the United States, pursuant to which the company issued to her two "policies." One was an annuity contract in standard form and the other was a so-called "Single Premium Life Policy", also in standard form, containing the usual provisions for cash surrender, change of beneficiary, optional modes of settlement at maturity, etc. (R. 11–13). The insurance policy also contained a provision for participation in dividends (R. 12). The insurance company would not have issued the insurance policy without the annuity contract because of the age of the decedent. It would have issued the annuity contract without the insurance policy. No physical examination of decedent was required by the insurance company (R. 14).

The annuity contract provided for payment to the decedent of $390.84 per year; the life-insurance contract provided for the payment of $20,000 to the decedent's daughter upon the decedent's death (R. 11). For the two policies the decedent paid the insurance company in advance the sum of $21,200; of that amount $3,258.20 represented the premium for the annuity contract, and $17,941.80

represented the premium for the "insurance" policy (R. 11–12). The annuity payments which the insurance company agreed to make to the decedent amounted to slightly less than 2 percent of the aggregate amount paid by decedent to the company, and this was considerably less than the insurance company was earning on its own funds held for investment (R. 17). The total amount to be paid by the company at decedent's death was $1,200 less than the aggregate amount paid by the decedent to the company, the total premiums being 106 percent of the face amount of the "insurance" policy (R. 14).

The name given to the $1,200 excess in the aggregate amount of the premiums over the face amount of the policy is "loading" and is for the purpose of paying commissions to the general agent and the special agent and for premium taxes. The actual expense, exclusive of general overhead expense, of the insurance company in issuing the two policies was $1,475.97. The total charge of 106 percent for combined annuity and life insurance contracts was later found by the insurance company to be unprofitable and the charge was increased to 110 percent. Still later the issuance of an insurance policy like the one here involved was made conditional upon a medical examination (R. 14–15).

Each policy provided that the policy and the application therefor "constitute the entire contract between the parties" (R. 11–12). The premiums on the policies were computed on the basis of dif-

ferent mortality tables, the mortality table used for the annuity policy showing a longer life expectancy for the decedent than that used for the insurance policy (R. 14).

The company treated the two contracts as two separate transactions. Although the amounts received from decedent for both policies were merged with the general funds of the company, the premiums were credited to different accounts and the commissions paid were likewise charged to different accounts. Similarly, in its reports to the state Superintendent of Insurance, the company reported its liability with respect to the two policies under different headings (R. 15–16).

The Commissioner determined that both policies were purchased as part of a single transaction, that the proceeds of the life insurance policy were not received "as insurance" within the meaning of Section 302 (g) of the Revenue Act of 1926, and that, consequently, decedent's estate was not entitled to the $40,000 insurance exemption provided by Section 302 (g). Treating the entire transaction as a transfer made to take effect at or after death within the meaning of Section 302 (c) of the 1926 Act, the Commissioner determined a deficiency of $3,243.64 (R. 5–7). The Board of Tax Appeals reversed this determination, holding that the proceeds of the life insurance policy were received "as insurance" and that the estate was therefore entitled to the exemption (R. 19–26). The Circuit Court of Appeals, re-

garding the issuance of the two policies as a single transaction eliminating all insurance risk (R. 74), reversed the decision of the Board of Tax Appeals (R. 77).

ARGUMENT

This case presents the same question as that involved in *Helvering* v. *Le Gierse et al.*, No: 237, present Term with which the present case is to be argued. Reference is made to the Government's brief in the *Le Gierse* case for the principal arguments in support of our position here. Several of the contentions advanced by petitioners in this case, however, require further brief comment.

1. Petitioners attempt to establish the independence of the two contracts by pointing to the fact that the rate of the premium charged for each policy was computed without reference to the rate of the premium to be charged for the other (Br. pp. 12, 14). This fact is only a half truth. Although the rate of each premium may have been determined without reference to the rate of the other, the rate of each was determined by reference to the same factor—the life expectancy of the insured. As we point out in our brief in the *Le Gierse* case (pp. 18–20), it is precisely because the life expectancy of the insured is the basic element in the computation of both premiums that the two types of policies, when issued in conjunction, serve to counteract one another economically.

The situation is not altered by the fact that the insurance company used different mortality tables in computing decedent's life expectancy for purposes of the two policies. The record reveals that the mortality table used for the annuity contract shows a longer life expectancy for a woman of decedent's age than the mortality table used for the insurance contract (R. 14). Certainly the fact that the insurance company in each instance used the mortality table most favorable to it in no way detracts from our position that, by issuing the two policies in conjunction, the company eliminated all insurance risk.

Although, for the reasons stated, it is not necessary for the elimination of insurance risk that the rate of each premium be computed with reference to the rate of the other, it is necessary that the amount of the annuity issued to the insured be computed with reference to the amount of the insurance policy which is taken out; i. e., the annuity must be large enough so that the premium paid for it will, when added to the premium paid for the insurance policy, equal or exceed the face amount of the insurance policy. And the record in this case shows that this is exactly what the insurance company required. At the time of its agr ment with the decedent, the company was issuing what is called "the 106 per cent combination" (R. 54); that is, the company required the

issuance of an annuity policy large enough so that the aggregate premiums paid by the insured for that policy and for the insurance policy amounted to 106 percent of the face amount of the insurance policy. Later, when this proved to be unprofitable because of the amount of the "loading" expenses, "the charge was increased to 110 percent" (R. 15); in other words, the insured, for the same amount of "insurance" was required to buy a larger annuity. A more conclusive demonstration of the complete interdependence of the two policies would be difficult to imagine.

Attention is also invited to the following finding of the Board (R. 14), which is based on the testimony of an insurance agent called as a witness by petitioners (R. 53–57):

> The total consideration paid by the decedent to the insurance company for the two contracts amounted to 106 percent of the face amount of the insurance policy or $21,200, which was $1,200 in excess of the face amount of the insurance policy. The name given to the $1,200 by the insurance company is "loading" and is for the purpose of paying commissions to the general agent and the special agent and for premium taxes.

This finding shows clearly the purpose and intent of the insurance company, by the issuance of the two policies in conjunction, to assure payment to

itself of an aggregate amount equal to the face amount of the insurance policy, together with an amount to cover "loading" expenses. It furnishes complete refutation of the contention that the two policies were regarded by the company as independent of one another.

2. Petitioners' contention that the company assumed an insurance risk is completely without merit. It is true that the Board found that through the issuance of the annuity contract in connection with the insurance policy, "the company reduced but did not entirely eliminate its risk against loss due to premature death" (R. 14). But the findings, when read as a whole, and the testimony of petitioners' witness upon which the findings were based (R. 52–58), show that what the Board had reference to was the fact that, if the decedent died within a short time after entering into the agreement, the company would suffer an out-of-pocket loss of some $275.97 because the "loading" charges included in the premium payments were less by that amount than the actual loading expenses. Certainly, as the court below stated (R. 74), the fact that the company may have made a slight miscalculation in loading charges does not establish that, in entering into the agreement, it undertook an insurance risk. It is significant that, sometime after the contract with decedent was made, the company required 110 percent

rather than 106 percent coverage of the face amount of the insurance policy, thus providing for all loading charges in full.

In this connection, it is interesting to contrast the findings of the Board in this case, in the *Le Gierse* case, and in *Tyler* v. *Helvering,* No. 368, present Term, all of which involve the same question. Here, where 106 percent coverage was required, the Board found a reduction but not an entire elimination of risk of loss; in the *Le Gierse* case, where 108½ percent coverage was required, the Board found that "it could be stated with almost certainty" that there would be no loss (R. 14); and in the *Tyler* case, where 110 percent coverage was required, the Board found that the agreement "could not involve the insurance company in any loss" (R. 15). Since the same type of transaction was entered into in each of the cases, it is apparent that the difference in the Board's findings is based solely on the difference in the calculation of "loading" charges; as we have stated, this does not involve an insurance risk.

Petitioners' further argument (Br. 22) that, if decedent had died shortly after making the agreement, there would have been no contribution to the company's general overhead and no profit to the company is plainly irrelevant. Any contribution to general overhead would, of course, reduce the overhead attributable to the company's other business and would therefore make that other

business more profitable. But the absence of profit clearly does not establish the presence of loss and, as we point out in our brief in the *Le Gierse* case (pp. 12–15), it is risk of loss which is the essential element of insurance.

Finally, petitioners seek to establish a risk of loss by pointing to the situation which would have existed had the decedent during her lifetime surrendered the life insurance policy for its cash surrender value but left the annuity contract in force; they assert that the court below erred because it failed to take this possibility into account (Br. 27–28). But the inquiry of the court below was directed, as the inquiry must be directed here, to the question of whether there was an insurance risk, and this necessarily assumes continuance of the insurance policy. If the policy were cancelled, there would obviously remain no insurance risk. Consequently, a showing of risk of loss on the annuity policy based upon cancellation of the insurance policy cannot be used to establish the existence of insurance. As a matter of fact, the risk of loss on the annuity policy in this situation would be less than the ordinary risk of loss on an annuity policy issued alone, since the company would have received, as consideration for its assumption of risk, not only the ordinary premium but also the difference between the premium for the insurance policy and the cash surrender value of that policy. Stated otherwise, cancellation of

the insurance policy, far from creating an insurance risk, would have assured the company a profit on the issuance of the policy.

CONCLUSION

The decision of the court below should be affirmed.

Respectfully submitted.

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SUPREME COURT OF THE UNITED STATES.

No. 371.—October Term, 1940.

Pius P. Keller, and Marcella V. Keller, Petitioners, *vs.* Commissioner of Internal Revenue, Respondent.	On Writ of Certiorari to the United States Circuit Court of Appeals for the Third Circuit.

[March 3, 1941.]

Mr. Justice Murphy delivered the opinion of the Court.

This case is companion to Number 237, *Helvering* v. *Le Gierse*, decided this day. In all material respects the facts are alike except for the differences to be noted. Here the annuity contract provided for annual payments of $390.84 and cost decedent $3,258.20. The "insurance" policy stipulated for payment of $20,000 to decedent's daughter at decedent's death, and the single premium was $17,941.80. Decedent was 74 at the time the contract was executed and died about two years later. Proceeding on the same theory as in the *Le Gierse case*, the Commissioner assessed a deficiency in the federal estate tax which the Board of Tax Appeals reversed. 39 B. T. A. 1047. The Circuit Court of Appeals in turn reversed the Board of Tax Appeals. 113 F. (2d) 833. The case is here because of conflict with the *Le Gierse* case (110 F. (2d) 734). 311 U. S. —.

Petitioners contend that this case is distinguishable from the *Le Gierse* case because here the insurance company found that the total consideration for the two contracts, which was 106% of the face value of the policy, was inadequate. They point out that the rate for this combination of contracts was later increased to 108% and finally to 110%. Further, they contend that absence of physical examination does not establish absence of risk, and that the Board of Tax Appeals found that there was "some" risk to the insurance company.

We find the distinctions insufficient to require a different result. It is not enough to show that the insurance company assumed "some" risk. A bank assumes a risk when it accepts a depositor's

funds and invests them. The investment may prove to be an unsafe one, or the bank may have agreed to pay the depositor a higher rate of interest than it can profitably earn on the funds it invests. Indisputably this is a risk. But it is not an insurance risk in the sense explained in the *Le Gierse* case. That the insurance company subsequently changed the total charge for this particular combination of contracts because it was unprofitable does not establish the existence of an insurance risk. Rather, it illustrates strikingly the interrelation of the two agreements and emphasizes the effort of the company to remove all possible investment risk.

Absence of a physical examination may well be inconclusive as to the existence of an insurance risk. For example, some companies do not require such an examination for group insurance. But there the risk as to one is distributed among the group, an insurance risk squarely within the definition stated in the *Le Gierse* case. Here the annuity issued with the policy did more than substitute for a physical examination. It removed the necessity for any risk distribution and completely countervailed a risk otherwise assumed in the "insurance" policy.

The finding by the Board of Tax Appeals that there was some risk necessarily is ambiguous in view of their finding that the company annually earned from 3½ to 4 percent on its own investments. It is therefore reasonable to conclude that the "risk" referred to was a risk that the funds might not earn enough to cover profitably the annuity payable to the decedent, or a risk due to a miscalculation of the proper total consideration. In either event it is not a finding of the existence of an insurance risk.

Since the case is not distinguishable from *Helvering* v. *Le Gierse*, *supra*, the judgment of the Circuit Court of Appeals is affirmed.

The CHIEF JUSTICE and Mr. Justice ROBERTS think the judgment should be reversed for the reasons stated in the opinion of the Circuit Court of Appeals for the Second Circuit in *Commissioner* v. *Le Gierse*, 110 F. (2d) 734.